

**ADMINISTRATION'S FISCAL YEAR 1986 BUDGET
PROPOSALS RELATING TO IRS**

HEARING
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

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ADMINISTRATION'S FISCAL YEAR 1986 BUDGET PROPOSALS RELATING TO IRS

MONDAY, APRIL 29, 1985

HOUSE OF REPRESENTATIVES,
COMMITTEE OF WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met at 10:35 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

[For immediate release, Thursday, April 4, 1985]

THE HONORABLE J.J. PICKLE (D., TEX.), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING TO CONSIDER THE ADMINISTRATION'S FISCAL YEAR 1986 BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE

The Honorable J.J. Pickle (D., Tex.), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a hearing to examine the Administration's fiscal year 1986 budget proposals relating to the staffing levels and allocation of resources of the Internal Revenue Service [IRS]. The hearing will be held on Monday, April 29, 1985, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 1:00 p.m.

IRS budget documents show substantial cuts in training, collection, returns processing, and taxpayer service. Further, examination coverage will drop to the lowest ever—1.2 percent. In announcing this hearing, Chairman Pickle stated: "IRS is the primary revenue-raising arm of the government. As such, IRS must have the ability to administer the tax laws fairly and efficiently. Each and every taxpayer needs to have confidence that IRS will collect taxes due the Federal Government in an appropriate, equitable and timely manner. It's not clear, however, whether the Administration's plans for IRS will provide that confidence. I am particularly concerned because of the growing number of complaints from taxpayers about the inadequate services of IRS."

This hearing is being conducted as part of the Subcommittee's current review of overall IRS operations and practices. The Subcommittee anticipates that further hearings in connection with this review will be held later this year.

Witnesses expected to appear at the hearing include the Honorable Roscoe L. Egger, Jr., Commissioner of the Internal Revenue Service; the U.S. General Accounting Office; the National Treasury Employees Union; and concerned tax practitioners.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler [(202) 225-3627] no later than Wednesday, April 17, 1985, to be followed by a formal written request to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This process will afford more time for Members to question witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 100 copies of their prepared statements to the Committee office, room 1102 Longworth House Office Building, by close of business, Wednesday, April 24, 1985. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

Requests to be heard, prepared statements to be presented in person, and statements filed for the printed record of the hearing, must contain the following information:

1. The name, full address, and capacity in which the witness will appear (as well as a telephone number where the witness or a designated representative may be reached);
2. A list of any clients or persons, or any organization for whom the witness appears; and
3. A topical outline or summary of comments and recommendations.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

Persons submitting written statements for the printed record of the hearings should submit at least six (6) copies by the close of business, Friday, May 3, 1985, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. (See other requirements enumerated above.) If those filing written statements for the record of the printed hearings wish to have their statements distributed to the press and the interested public, they may provide 100 additional copies for this purpose to the Committee office before the hearing scheduled for April 29, 1985, begins.

Chairman PICKLE. I will ask the subcommittee to come to order, and we will proceed.

This morning, the Subcommittee on Oversight will be reviewing the administration's proposed budget for the Internal Revenue Service. We begin our work on this budget knowing that the most important issue facing our Nation is reducing the Federal deficit.

The Internal Revenue Service collects over 90 percent of the Federal revenues. It therefore plays a critical and unique role. Unlike any other agency of our Government, the IRS raises many times more revenue than it spends. Therefore, we must ensure that the Service is given adequate resources to do the job of administering the tax laws.

In analyzing the IRS budget, we should remember that IRS has already worked hard to control its spending. There has been a very real commitment to improving the Service's administrative efficiency. Over the past several years, its computer systems have been modernized, staffing has been cut, and operations streamlined.

Even so, each year more taxpayers file more returns, the tax gap continues to grow, voluntary compliance continues to decline, and the IRS must collect more revenue. Under this budget, the IRS now proposes to accomplish its responsibility to administer the tax laws with fewer people than in fiscal year 1980.

In addition to being efficient, the Service must be thorough and see that all taxes due are collected. If we are going to address our national deficit, we must be assured that everyone is meeting their tax obligation. All must pay their fair share. Under this proposed budget it is questionable whether the IRS will have sufficient re-

sources to ensure that taxes are assessed and collected in a fair, equitable, and timely manner.

Finally, given the Service's emphasis on efficiency and our national need to collect all the revenue legally owed, we must be careful we do not lose sight of or forget the needs of the taxpaying public. It is vitally important that we treat taxpayers fairly. Under the administration's proposed budget it is unclear whether the IRS will be able to continue providing taxpayers with meaningful and timely assistance in their efforts to comply with our tax laws. Furthermore, we must not become so efficient that we fail to devote appropriate attention to the procedures for protecting taxpayers in their dealings with the Service. Our income tax system depends on voluntary compliance by the public. Our record in this regard is the envy of the world. It must not be sacrificed for any short-term budget saving.

This hearing is to review the Service's past record and future plans in accomplishing these objectives. I expect that we will then be making recommendations on how these goals should be attained. I hope that our witnesses today will feel free to speak frankly and help us. By working together we will all be winners because full, fair, and efficient enforcement of our tax laws benefit everyone.

We will also be receiving reports from the IRS and the GAO on the snafu's in the Philadelphia Service Center.

It seems as if the more we look, the worse it gets. Maybe the Philadelphia Center is just snakebit. If it was all alone in this we could just make some local corrections and move on. But we can't be sure.

Last week there were reports of problems in the Austin Service Center, and I have to say that is terribly worrisome to me.

Mr. Commissioner, we have information in our records concerning a huge backlog in collections, and we are behind in our work. Today, the newspapers speak out about the inadequacy of the IRS collection system—the New York Times, the Washington Post, the Wall Street Journal. It seems to me they are openly criticizing our present operation. So, I want reports and comments on those places as we move forward.

I will ask the Commissioner of Internal Revenue, our good friend, Mr. Roscoe Egger, to come forward to the witness table, take his place and I invite you to have any staff with you that you would like, Mr. Egger.

We are glad to have you here.

First, let me ask Mr. Schulze if he cares to make a statement.

Mr. SCHULZE. Thank you, Mr. Chairman.

I want to thank you, Mr. Chairman, for calling this hearing today. The Internal Revenue Service budget is too crucial to this Nation to be passed on by Congress without a thorough examination. No other Federal agency has a more immediate impact on, or touches more people, than the Internal Revenue Service.

First, let me say that I applaud the administration's determination to eliminate unnecessary Federal expenditures. In this modern world, no organization has the luxury of remaining stagnant. The same standards should apply to Government as apply to the pri-

vate sector. Unless Government is required to operate efficiently, we would be treating unfairly those taxpayers who pay for it.

However, I am very concerned that Commissioner Egger will be able to assure Congress that the administration's budgeted funding for the Internal Revenue Service during fiscal year 1986 will enable the Service to administer this Nation's tax laws in an equitable and efficient manner.

In regard to efficiency, we are all aware that many organizational changes are going on within the Internal Revenue Service. It is essential that the Internal Revenue Service have the resources necessary to accomplish those changes smoothly, and avoid the kind of disasters experienced in the Philadelphia Service Center.

I hope that Commissioner Egger will review for us the status of his efforts to resolve the Philadelphia Service Center disaster, and in particular whether the Philadelphia tape problem is indicative of other problems in Philadelphia or a pattern of problems extending to other service centers.

It is absolutely essential that taxpayers feel they are being dealt with in a fair and efficient manner by our tax administrators. The importance of an effective operation of service centers in the overall context of our volunteer compliance tax system cannot be overstated. Internal Revenue Service breakdowns, like that which occurred in Philadelphia Service Center, not only unfairly waste taxpayers' time, they can only serve to undermine public confidence in the IRS's accuracy and thoroughness.

Internal Revenue Service breakdowns may well have ramifications beyond those taxpayers involved. We are constantly advised by senior Treasury and Internal Revenue Service officials that there are compliance problems with respect to the individual tax system which periodically require various forms of legislation. Congress has enacted many new compliance provisions. I believe they will achieve little in the way of progress if taxpayers do not feel that the IRS is being run in an efficient manner.

Let me say that I have the utmost respect for Commissioner Egger. In this period of budgetary frugality and modernization of the Internal Revenue Service, he has been an exemplary administrator. I certainly admire the Commissioner for the effective job which he has done in his 4 years as Commissioner, and I look forward to being able to work with him on these important matters and working to solve some of these problems as they arise. I know he feels as strongly about them as we do, and I look forward to hearing the Commissioner's testimony.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Egger, we are pleased to have you here this morning in such a pleasant atmosphere. We will ask you to proceed.

STATEMENT OF HON. ROSCOE L. EGGER, JR., COMMISSIONER OF INTERNAL REVENUE, ACCOMPANIED BY JIM OWENS, DEPUTY COMMISSIONER; PHIL COATES, ASSOCIATE COMMISSIONER FOR OPERATIONS; ED HEIRONIMUS, ASSOCIATE COMMISSIONER FOR DATA PROCESSING; NORM BOLZ, ASSOCIATE COMMISSIONER FOR POLICY AND MANAGEMENT; FRED GOLDBERG, CHIEF COUNSEL; AND STEVE TAYLOR, DIRECTOR, FINANCE DIVISION

Mr. EGGER. Mr. Chairman, my testimony says I am pleased to be here today. I would like to amend that and say I am willing to be here today, but I really am pleased to talk about our 1986 budget, and I think it is a healthy opportunity to review our thinking there.

I should identify the staff people here with me at the table.

I have here on my right Jim Owens who is the Deputy Commissioner and also I have with me on my left Steve Taylor who is the director of our Finance Division.

There are other officials here with me, Mr. Chairman, who could be available to answer questions that I might not be able to answer completely or fully.

Before I begin the discussion of the budget, I would like to talk with you a little bit about the Austin Service Center matters to which you made reference.

The recent newspaper stories that have appeared regarding an incident at the Austin Service Center deserve a brief comment here.

Last Friday, my office received word that an official of the National Treasury Employees Union [NTEU] at the Austin Service Center went to the Austin Statesman, one of your local newspapers, and gave them a story that suggested that a large number of items of taxpayer correspondence had been destroyed at the center.

Unfortunately, it appears that the substance of the charge is correct. I can assure you that appropriate investigatory and other action is being taken with regard to this incident.

Our most current information suggests that late last year a first-line unit supervisor in the Austin Service Center instructed an employee to destroy taxpayer correspondence. That unit supervisor was confronted with these charges and promptly resigned.

We are continuing to investigate facts of this extremely unfortunate incident. Our best information indicates that no tax returns were destroyed. The destruction of records took place in the adjustment unit of the Austin Service Center where taxpayers' correspondence is handled.

As I mentioned, I intend to take appropriate action in this matter. However, I feel it is important to safeguard the interests of the employee who ultimately had the sense of duty and good judgment to come forth and bring this problem to the attention of senior management.

Chairman PICKLE. Commissioner, before you go further, were you apprised of this loss of documents last fall?

Mr. EGGER. No, indeed. I learned about it last Friday.

Chairman PICKLE. Has the Austin Service Center reported that to anyone here in Washington?

Mr. EGGER. No.

Chairman PICKLE. Did the Austin district service officer know of this event?

Mr. EGGER. It is my information they did know about it, but I do not have the details yet.

Chairman PICKLE. When did they know about it?

Mr. EGGER. The report took place in January.

Chairman PICKLE. In January 1985?

Mr. EGGER. Yes, sir.

Chairman PICKLE. It was reported to them by someone in the IRS?

Mr. EGGER. An employee who participated in the destruction reported it to her supervisor.

Chairman PICKLE. So, a supervisor in the IRS did know of the event after it happened or when it happened?

Mr. EGGER. That is correct.

Chairman PICKLE. Did that supervisor report to the supervisory officials?

Mr. EGGER. Those are the details that we have under investigation right now.

Chairman PICKLE. That is not just a detail, Mr. Egger. That goes to the heart of many things.

Mr. EGGER. The details of just when and to whom the reports were made is part of the investigation.

Chairman PICKLE. I would like you to give me an official report on how it was handled locally, why it was not reported here, what they did to correct it or change the allegation.

Mr. EGGER. I certainly will.

[The following was subsequently received:]

REPORT ON AUSTIN SERVICE CENTER INCIDENT

An internal investigation at the Austin Service Center [AUSC] has disclosed that in mid-December 1984, a firstline supervisor improperly ordered the destruction of taxpayer correspondence contained in suspense inventory cases. Approximately 4000-6000 cases were handled in this manner, though there is no way to determine the exact number destroyed. In addition, due to the lack of identification of the documents involved, it cannot be determined whether the incident impacted adversely on taxpayers or caused a loss of revenue to the government.

On January 9, 1985, a Tax Examining Assistant reported to a Branch Chief that the destruction of taxpayer correspondence without the normal quality review had been ordered by the supervisor. Thereafter, the Chief of the Tax Accounts Division was informed of the allegation against the supervisor and on January 10, 1985, the allegation was reported to AUSC Assistant Director Stephen J. Stalcup and subsequently to AUSC Director, G. William Grabo.

Grabo has confirmed that he was advised of the allegations on January 10, 1985. He was informed that no numbered documents, original returns, active notices or taxpayers claims were ordered destroyed and he has received no information to date contrary to that initial report. He asked to be kept informed of the case and instructed all AUSC division chiefs to insure that all procedures were being followed and that no one was improperly disposing of inventory. After the supervisor resigned on January 15, 1985, the best determination that could be made was that this was an isolated incident and no other employees were involved. It is Mr. Grabo's belief that no documents were destroyed that could affect the accuracy of the taxpayer's accounts.

Chairman PICKLE. We want to know more about that.

You may proceed.

Mr. EGGER. Mr. Chairman, in keeping with the administration's goal of limiting the Federal budget by freezing spending in fiscal

year 1986, the budget for the Internal Revenue Service provides for average employment of 86,489 and some \$3.5 billion to administer the Nation's tax laws. This is a decrease of 1,254 average positions and \$30.4 million from the revised level for fiscal year 1985.

Our fiscal year 1986 budget has five major goals: To maintain essential levels of tax administration; to continue efforts begun over the last few years to modernize ADP systems; to implement the Deficit Reduction Act of 1984; to begin to hire revenue agents for the expansion of examination efforts in fiscal years 1987-89; and to achieve necessary reductions and meet uncontrollable cost and workload increases. Let me summarize each of these for you.

One, maintaining tax administration. Our first goal is to maintain essential levels of tax administration. In fiscal year 1986, we will also process 5.7 million additional tax returns and supplemental documents, and provide timely tax law and account assistance to over 55 million taxpayers through direct assistance or taxpayer education.

Maintaining tax administration also includes providing basic funding to continue participation in the President's Task Forces on Organized Crime and Drug Enforcement. The Service's resource commitment to this effort is the largest of any Treasury bureau. During fiscal year 1984, the Service's participation in the task forces resulted in the initiation of 618 investigations, 440 prosecution recommendations, and 177 convictions.

Two, ADP modernization. A second major goal of this budget is to continue ADP modernization projects initiated in prior years, such as optical character recognition, the automated collection system, and the automated examination system.

Three, Deficit Reduction Act. A third initiative in our budget is to perform essential new work relating to the Deficit Reduction Act of 1984, which added or changed many tax provisions. The Service will devote time and resources to issuing regulations and rulings, updating tax forms and instructions, following through on tax shelter registrations, and matching of mortgage interest payments.

Four, revenue initiative. A fourth major goal is to advance hire, late in the year, a large number of revenue agents. These new staff years will be devoted to a major revenue initiative that begins in fiscal year 1987. This initiative will increase revenue by an estimated \$4.6 billion over the 3-year period by adding 2,500 average positions each year to the examination of tax returns.

To give you a clearer understanding of this revenue initiative, Mr. Chairman, I would like to refer to a few charts.

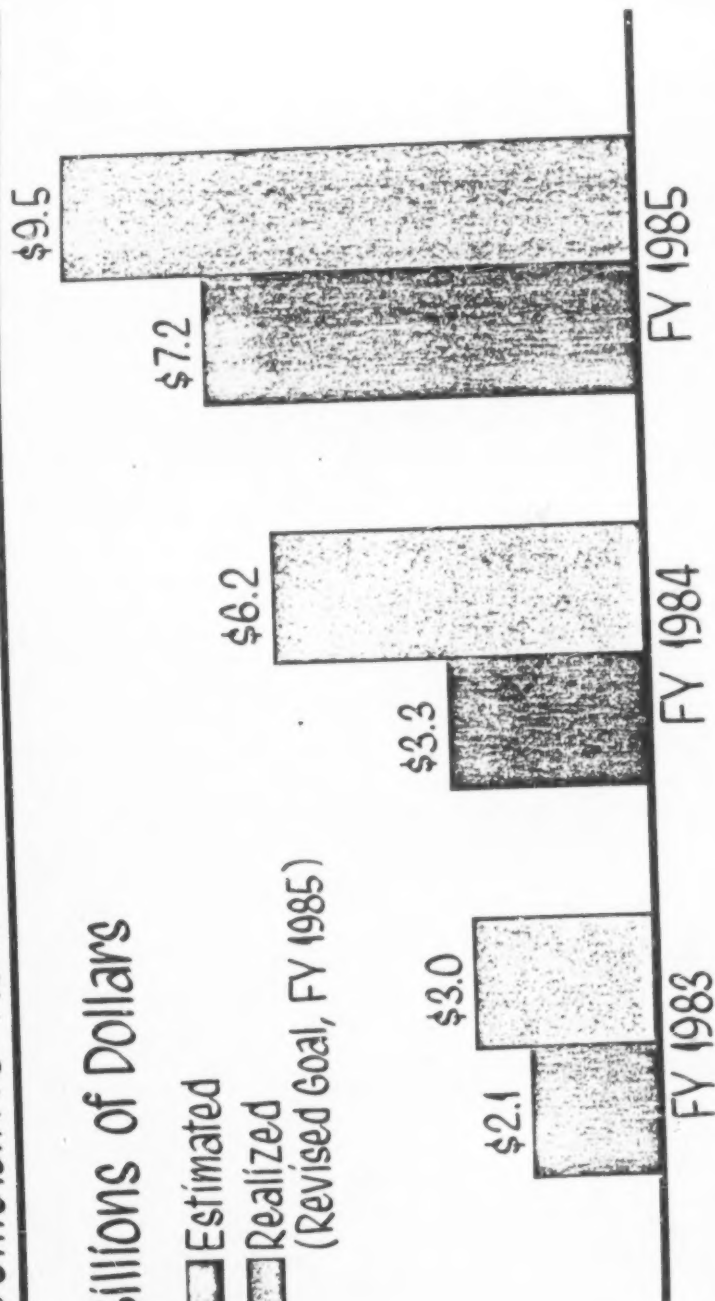
[A chart follows:]

FY 1983 Revenue Initiative Cumulative Revenue Collections

Billions of Dollars

Estimated

Realized
(Revised Goal, FY 1985)



Mr. EGGER. In the first chart, we are committed, as I said, to long-term health and integrity of the tax system. We have established what we think is a solid foundation to support this system. Congress passed the Bank Withholding Act and, more recently, the Deficit Reduction Act.

We have also emphasized investment in technology to improve our processing.

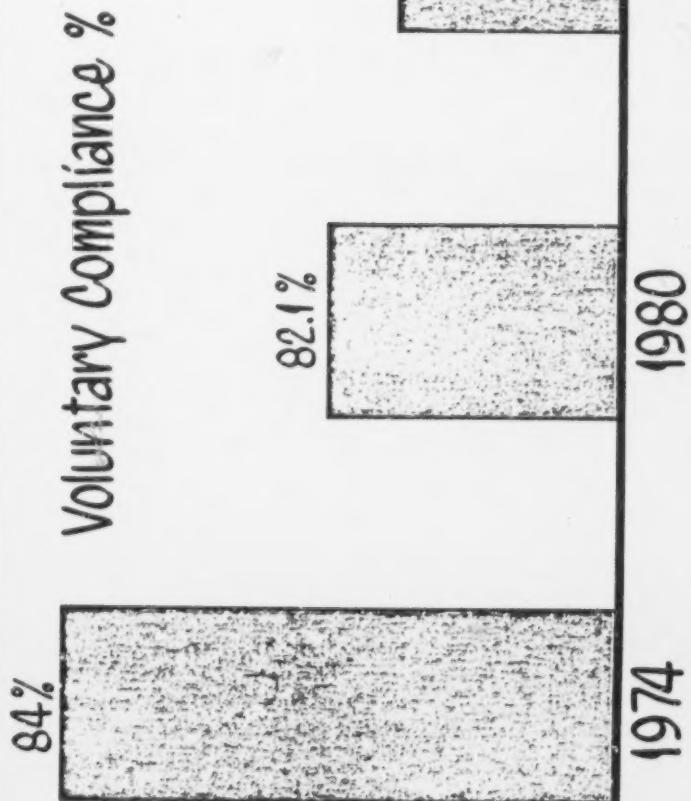
What this shows, Mr. Chairman, is the cumulative revenue collections starting fiscal year 1983, 1984, and 1985 which resulted from the revenue initiative that we began in fiscal year 1983. At that time, we added 5,225 positions, mainly in collection although 1,000 of them were in examination and about 225 were in appeals to help bring down the case workload there.

As you can see, our proposal, when we put that initiative forward, was that over the 3-year period, we would increase the revenues by \$7.2 billion. In fact, what has happened is that we have increased revenues of the country by \$9.5 billion so that revenue initially has been more than adequate and has paid its way.

[A chart follows:]

Income Tax Compliance

FY 1974 - FY 1986



Mr. EGGER. In the second chart, Mr. Chairman, we see what has happened to the compliance level in our country in the past 12 years beginning in 1974, and we have projected it to 1986.

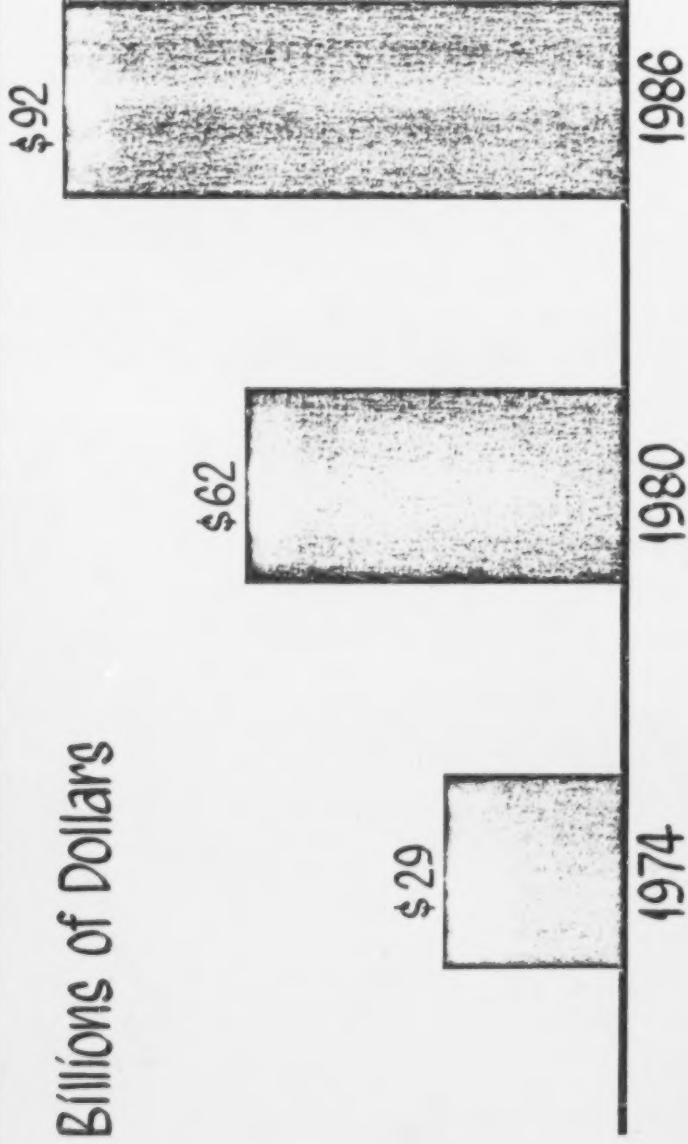
It shows that the compliance level in 1974 was across the board about 84 percent; whereas, it has dropped to 81.6 or will have by 1986.

When you keep in mind that for every percentage of drop in compliance level the revenue loss is about \$5 billion a year that gives you an idea of the consequence in just sheer revenue dollars alone, to say nothing about the fallout effects of the integrity of the system.

In the next chart, we show what happens to the income tax gap.
[A chart follows:]

Total Income Tax Gap Fiscal Years 1974 - 1986

Billions of Dollars



Mr. EGGER. Here, when I talk about income gap, Mr. Chairman, I am talking about the difference between the dollars which are owed under the law and the dollars that are actually paid by taxpayers without any enforcement action taken on our part. That is to say, no collection action, no auditing, et cetera. You can see that, back in 1974, the dollar amounts were by modern terms rather modest, \$29 billion.

Chairman PICKLE. Does that mean, Mr. Commissioner, in 1974 we had \$29 billion that was underreported, in effect?

Mr. EGGER. That is correct.

I beg your pardon. In 1980, it grew to \$62 billion and we project now by 1986 it will be \$92 billion.

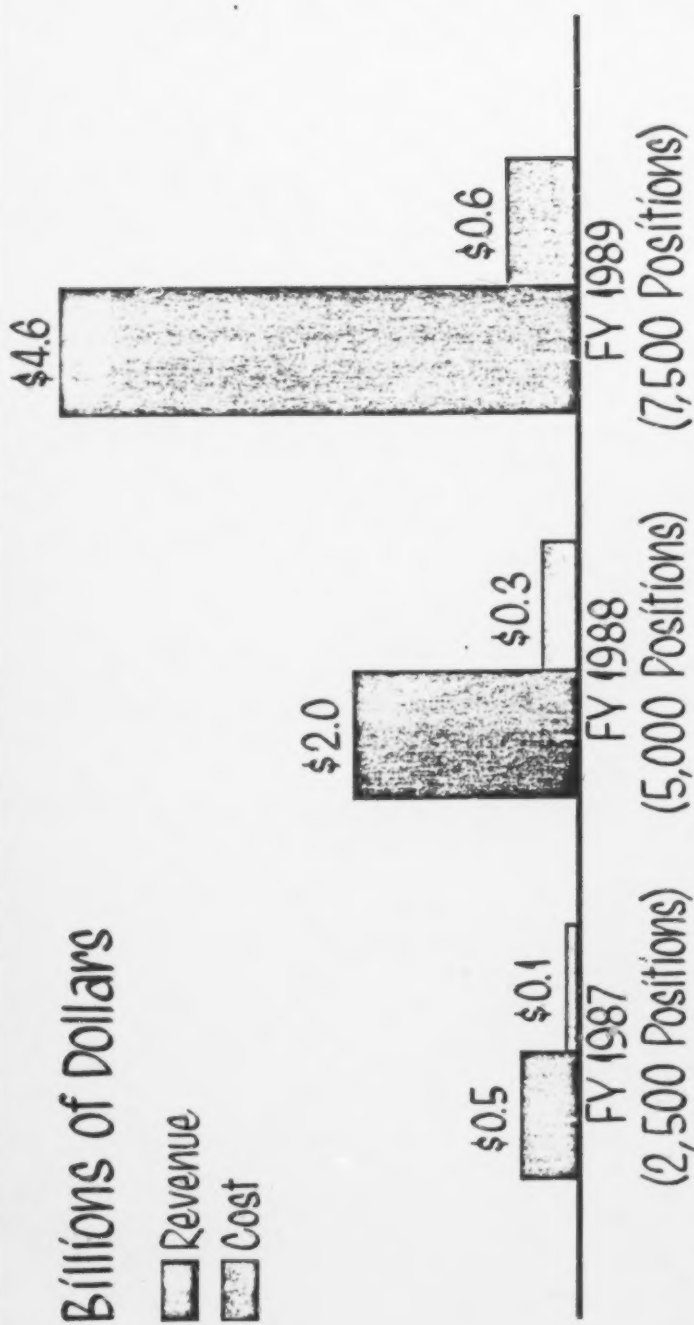
Mr. SCHULZE. Are those figures adjusted for inflation?

Mr. EGGER. They are actual dollars. They are not constant dollars. We have some other charts expressed in constant dollars. This is to show you what the tax gap has amounted to and how it is growing over the period.

I would like to say here and I have said before, Mr. Chairman, that we do not have current statistical data with which to determine what have been the effects of the amendments that have come into the tax law since 1981 having to do primarily with efforts to curb tax sheltering, improper tax sheltering, and that type of thing. My belief is, and this is simply a perception, that the rate of growth may have slowed somewhat. These figures are based on trends which developed from our 1979 statistics which are the latest ones we have.

[A chart follows:]

FY 1987-89 Revenue Initiative Cumulative Revenue and Cost



Mr. EGGER. In the next chart, the revenue initiative which we project for 1987 to 1989 is in constant dollars, and this shows that the yellow bar is the revenue and the blue bars are the costs and it shows that over this period of time by adding 2,500 positions to our examination effort over that 3-year period, it would bring in an aggregate of \$4.6 billion over the 3-year period as against the cost of \$26 billion, so we have \$626 million, and we achieve \$4.6 billion in revenues. That is in our proposal for the fiscal period beginning in fiscal year 1987.

[A chart follows:]

Revenue from Enforcement and IRS Budget



Mr. EGGER. The last chart that I have here shows what has happened to revenues from our Enforcement Program. I point out to you that beginning in 1984, the orange bar shows the revenues which have come up and the blue bars show our costs. As you can see, and this, too, is in constant dollars, the costs have remained fairly flat, whereas our revenues have gone up dramatically in 1984.

Significantly, the amount of revenues beginning in 1984 tend to stay rather flat. The reason for that is the resources stay rather flat. So, there is a very direct correlation between the amount of resources we put into enforcement and the amount of revenue dollars which are reflected from those efforts.

Chairman PICKLE. Mr. Commissioner, what years were those charts?

Mr. EGGER. The last chart starts in 1980 and goes through 1986.

Chairman PICKLE. Have all of them accumulated over a period of 2 or 3 years?

Mr. EGGER. No, sir. Those are not cumulative figures. Those are actual figures.

Chairman PICKLE. Do they go from 1982 to 1984 to 1986? Are they for a single year?

Mr. EGGER. They are a single year.

Chairman PICKLE. Are you going to go back to your testimony now?

Mr. EGGER. Yes; I will ask that all of that testimony be included in the record and then I would like to kind of just now reach a conclusion here and then invite—

Chairman PICKLE. Put up the first chart again and then I will not hold you up on your testimony.

You show there your 1983 revenue initiative.

Mr. EGGER. Yes, sir.

Chairman PICKLE. It shows what a tremendous saving you have in the revenue initiative. I think the chart we have shows you might have saved a little more money than what that chart shows.

Mr. EGGER. The orange bars are the figures we projected initially in the 1983 revenue initiative. The blue bars are what we did in fact receive. Those are actual figures.

Chairman PICKLE. The point I am trying to make, Mr. Commissioner, is if these figures show you have a revenue initiative that is so favorable, my question then is if it has been so successful, why do you cut the staffing? If you are saving that much money on all these different charts, why do you now recommend cutting the staff?

Mr. EGGER. We are not cutting staff in the enforcement area, Mr. Chairman. That goes up a little bit in fiscal year 1986.

Chairman PICKLE. In all these areas, you are cutting all areas perhaps except examinations. I have to ask myself before you proceed, if you have been successful, now why do you turn around and cut the staffing in every category except one?

Mr. EGGER. I would be happy to respond to that, Mr. Chairman. That is in keeping with the desire of the administration to achieve a freeze in spending across the board, and the Internal Revenue Service is simply part of that.

Chairman PICKLE. Mr. Commissioner, I am not going to interrupt you anymore because I want you to present your testimony here. However, I must ask you and ask you to differentiate between the freeze and the efficiency and the fairness and the equity of the Internal Revenue Service collections. I do not want to relate that just to a freeze. You have to justify it on the basis of revenues.

Mr. EGGER. I understand. All I am saying to you, Mr. Chairman, is that that decision is an administration decision, and it is in keeping with the freeze on spending for fiscal year 1986.

Chairman PICKLE. I am not going to argue with you. I do not care if that directive is from up on high, in the clouds, in the heavens.

Mr. McGRATH. Would the chairman yield?

Chairman PICKLE. Yes; I did not mean to interrupt you, but I will yield to Mr. McGrath.

Mr. McGRATH. I would hope during the testimony that Mr. Egger would touch upon not only the areas of initiatives and collections but also the area of outstanding correspondence.

In my service center on Long Island, we have the largest outstanding correspondence in the country. How would you justify a lean budget for the IRS when there are over 200,000 cases of correspondence outstanding. That is something I would like to hear more about.

Chairman PICKLE. Will you comment on that, too.

Mr. EGGER. I will if I can complete just a couple of paragraphs, and then we can go through whatever line of questioning you and the other members would like to follow.

I will come back to that. It involves more than just a simple answer.

I would like to comment that one more goal which is achieving reductions while still meeting unavoidable cost and workload increases produces some \$240 million in savings and reductions. Efforts contributing to this reduction include cutting administrative staff by 10 percent, streamlining overhead and program support, achieving productivity savings from efficiencies in processing tax returns and from investments in ADP and systems modernization.

Overall, Mr. Chairman, our budget request follows the administration's goal of freezing spending in fiscal 1986 to limit the Federal budget within this objective. We will achieve the necessary reduction and cover unavoidable costs and workload increases, implement the Deficit Reduction Act of 1984, modernize our data processing systems and maintain essential levels of tax administration as well as begin a major revenue initiative plan for these outyears.

[The prepared statement follows:]

STATEMENT OF ROSCOE L. EGGER, JR., COMMISSIONER OF INTERNAL REVENUE

Mr. Chairman and members of the subcommittee, I am pleased to be with you today to discuss the FY 1986 budget of the Internal Revenue Service. In my testimony, I will first summarize the major areas of emphasis for FY 1986, then briefly review each of the activities in our four operating appropriations.

With me today are Jim Owens, the Deputy Commissioner; Phil Coates, the Associate Commissioner for Operations; Ed Heironimus, the Associate Commissioner for Data Processing; Norm Bolz, the Associate Commissioner for Policy and Management; Fred Goldberg, the Chief Counsel; and Steve Taylor, the Director of our Fi-

nance Division. All of us will be available to try and answer whatever questions you or the other Members may have at the conclusion of my opening statement.

AUSTIN SERVICE CENTER

Mr. Chairman, although the announcement for this hearing limited the subject area to be discussed to matters that involve the Internal Revenue Service's budget, the recent newspaper stories that have appeared regarding an incident at the Austin Service Center deserve comment. Last Friday, my office received word that an official of the National Treasury Employees Union [NTEU] at the Austin Service Center went to the *Austin Statesman*, one of your local newspapers, and gave them a story that suggested that a large number of items of taxpayer correspondence had been destroyed at the Center.

Unfortunately, it appears that the substance of the charge is correct. I can assure you that appropriate investigatory and other action is being taken with regard to this incident.

Our most current information suggests that late last year a first-line "unit" supervisor in the Austin Service Center instructed an employee to destroy taxpayer correspondence. That unit supervisor was confronted with these charges and promptly resigned.

We are continuing to investigate facts of this extremely unfortunate incident. Our best information indicates that no tax returns were destroyed. The destruction of records took place in the Adjustment Unit of the Service Center where taxpayers' correspondence is handled.

As I mentioned, I intend to take appropriate action in this matter. However, I feel it is important to safeguard the interests of the employee who ultimately had the sense of duty and good judgment to come forth and bring this problem to the attention of senior management.

FISCAL YEAR 1986 SUMMARY

Mr. Chairman, in keeping with the Administration's goal of limiting the federal budget by freezing spending in fiscal year 1986, the budget for the Internal Revenue Service provides for average employment of 86,489 and some \$3.5 billion to administer the nation's tax laws. This is a decrease of 1,254 average positions and \$30.4 million from the revised level for fiscal year 1985.

Our fiscal year 1986 budget has five major goals: to maintain essential levels of tax administration; to continue efforts begun over the last few years to modernize ADP systems; to implement the Deficit Reduction Act of 1984; to begin to hire revenue agents for the expansion of examination efforts in FY 1987-1989; and to achieve necessary reductions and meet uncontrollable cost and workload increases. Let me summarize each of these for you.

1. *Maintaining tax administration.*—Our first goal is to maintain essential levels of tax administration. In FY 1986, we will also process 5.7 million additional tax returns and supplemental documents, and provide timely tax law and account assistance to over 55 million taxpayers through direct assistance or taxpayer education.

Maintaining tax administration also includes providing basic funding to continue participation in the President's Task Forces on Organized Crime and Drug Enforcement. The Service's resource commitment to this effort is the largest of any Treasury bureau. During FY 1984, the Service's participation in the task forces resulted in the initiation of 618 investigations, 440 prosecution recommendations and 177 convictions.

2. *ADP modernization.*—A second major goal of this budget is to continue ADP modernization projects initiated in prior years, such as optical character recognition, the automated collection system, and the automated examination system.

3. *Deficit reduction act.*—A third initiative in our budget is to perform essential new work relating to the Deficit Reduction Act of 1984, which added or changed many tax provisions. The Service will devote time and resources to issuing regulations and rulings, updating tax forms and instructions, following through on tax shelter registrations, and matching of mortgage interest payments.

4. *Revenue initiative.*—A fourth major goal is to advance hire, late in the year, a large number of revenue agents. These new staff years will be devoted to a major revenue initiative that begins in fiscal year 1987. This initiative will increase revenue by an estimated \$4.6 billion over the three year period by adding 2,500 average positions each year to the examination of tax returns.

5. *Budget reductions.*—Our fifth goal, achieving reductions while still meeting unavoidable cost and workload increases, produces some \$240 million in savings and

reductions. Efforts contributing to this reduction include cutting administrative staff by ten percent, streamlining overhead and program support, achieving productivity savings from efficiencies in processing tax returns and from investments in ADP and systems modernization, reducing employee pay rates by five percent, and scaling down programs and staff in most activities by three percent. No program reductions will be applied to the examination or document matching programs.

FISCAL YEAR 1986 OVERVIEW

Before beginning my testimony on the particulars of the FY 1986 budget, I would like to take a moment to briefly explain two things about the process that shaped this document. First, the form and structure of our four appropriations were determined in large part by the appropriations committees in both houses, with whom we deal continually. Second, the development of this budget began many months ago. During its development, we have engaged in the usual "give and take" with both the Treasury Department and OMB over the exact shape the final budget would have. While reasonable people may differ over the outcome of these deliberations, we are satisfied that the important issues have been addressed and resolved.

In order for you to fully understand and appreciate the size, scope, and complexity of the Service's overall operations, let me briefly review the activities in each of our four appropriations.

1. SALARIES AND EXPENSES APPROPRIATION

Executive direction

The Executive Direction function includes my office, the Chief Counsel's office. The three Associate Commissioners, and the Assistant Commissioner (Inspection). Included in my office are the Equal Employment Officer, The Taxpayer Ombudsman. The Assistants to the Commissioner and their immediate staffs.

The budget for Executive Direction totals 127 average positions and \$8.4 million, a net decrease of one average position and an increase of \$12,000 for mandatory costs.

Management services

The management Services activity develops and provides Servicewide policy for managing the human, logistical and financial resources needed to fulfill the Service's tax administration mission in a cost effective manner. Specifically, Management Services is divided into the three following areas, each responsible for specialized support programs: Human Resources; Planning, Finance and Research; and Support and Services.

The FY 1986 Management Services request totals 1,944 average positions and \$87.5 million. A decrease of 135 average positions and \$10.1 million below the revised level for FY 1985. This reduction reflects savings from reducing administrative services, streamlining overhead support, and productivity.

For FY 1986, we are requesting that not to exceed \$500,000 remain available until expended in the Salaries and Expenses Appropriation for research. These no-year funds are important to allow completion of research projects which analyze the specific nature of particular tax gap components, address areas that represent new or potential areas of noncompliance, and identify factors affecting compliance.

2. PROCESSING TAX RETURNS APPROPRIATION

Returns processing and revenue accounting

This activity provides for processing tax returns, issuing refunds and notices of tax due, accounting for revenues, and processing information returns for document matching.

The resources requested for Returns Processing and Revenue Accounting total 21,336 average positions and \$760.9 million, a decrease of 239 average positions and \$18.9 million from FY 1985. With the resources requested, we will receive and process almost 179 million tax returns and issue over 81 million refunds to individual taxpayers.

The resources requested include 705 average positions and \$14.6 million to process almost 5 million additional tax returns and related schedules and some 752,000 additional supplemental documents, and to issue notices, tax bills and refunds promptly. This increase in staffing is being more than offset by saving 362 average positions and \$8.9 million due to anticipated employee productivity and procedural efficiencies; reducing 424 average positions and \$28.7 million by scaling down selected programs and cutting 168 average positions and \$5.3 million in administrative and overhead personnel which support processing tax returns.

An integral part of our returns processing system is to math verify the tax returns filed. This yielded a net \$2.2 billion in FY 1984.

Computer services

The Computer Services activity provides comprehensive developmental data processing support for the Service, including the development, acquisition, installation, and evaluation of computer systems for tax administration. The request totals 1,510 average positions and \$237.4 million, a decrease of 26 average positions and an increase of \$30.7 million over FY 1985.

The reduction in staffing reflects efforts underway to reduce administrative services and streamline support by 37 average positions and \$1.7 million. This reduction is offset by an increase, including 46 average positions due to annualization of ADP equipment and normal contract cost increases.

For FY 1986, we are requesting that not to exceed \$35.0 million remain available until expended for systems modernization initiatives in the Processing Tax Returns Appropriation. The purpose of this authority is to allow for the lengthy procurement process, site preparation and other unanticipated delays in acquisition of services, equipment and supplies to support approved ADP and systems modernization initiatives.

3. EXAMINATION AND APPEALS APPROPRIATION

Examination

I would like now to comment briefly on our Examination program. Examination of returns is one of the primary means through which full compliance is encouraged, errors corrected and public confidence in fair tax administration maintained.

Requested resources for the Examination program in FY 1986 total 29,518 average positions and \$1,126.6 million. A net increase of 322 average positions and \$1.1 million above the level of FY 1985.

At the requested program level, we plan to audit about 1.4 million returns in district offices and service centers and to make 1.3 million service center contacts and W-4 program contacts in FY 1986, including follow-up on underreporting of income disclosed by matching information returns filings with taxpayers' returns.

We estimate that the additional tax, penalties and interest assessed from these efforts will be \$14.7 billion, \$0.3 billion over that estimated for FY 1985.

This request for Examination includes an additional 290 average positions and \$10 million which supplements resources redirected this year from other work to implement the Deficit Reduction Act of 1984 (P.L. 98-369). These resources are needed to assure compliance with the tax shelter, cash received in a trade or business, foreign and general provisions of the Act.

In addition, 263 average positions are being transferred to Examination from the Returns Processing and Revenue Accounting activity to complete followup workload on 5.5 million underreporter document matching cases initiated in late FY 1985 for 1983 tax returns.

The Administration has included a major revenue initiative in the President's budget message for fiscal years 1987-1989. This initiative, which is also endorsed by the President's Private Sector Survey on Cost Control (Grace Commission), will increase revenue by \$4.6 billion over the three year period by adding 2,500 average positions each year to the examination of tax returns. Within the total budget request, the Service will begin to hire revenue agents late in FY 1986 to ensure selection of better qualified applicants and allow for initial training, thus improving their productivity in subsequent years.

Appeals and tax litigation

The Appeals program offers taxpayers an independent administrative review of contested tax assessments proposed by the Examination activity of certain penalties assessed by service centers and the Collection program, and of certain determinations made by the Employee Plans and Exempt Organizations programs. It provides taxpayers an opportunity to resolve disputes with the least possible delay and encourages compliance by maintaining public confidence in the Service's ability to administer the tax laws fairly and impartially. The Tax Litigation function represents the Service in judicial proceedings that cannot be resolved through administrative appeals.

A total of 3,537 average positions and \$155.4 million is requested in FY 1986 for Appeals and Tax Litigation, a decrease of 16 average positions and \$0.3 million below the FY 1985 level.

With the resources requested for Appeals, 1,000 additional taxpayer disputes are expected to be closed. In Tax Litigation, the requested level will allow for 38,188 Tax

Court and refund case closures. Ending inventory will increase by 17,400 cases as a result of litigation against abusive tax shelters.

Employee plans and exempt organizations

The Employee Plans function ensures voluntary compliance with those provisions of the Internal Revenue Code applicable to employee pension plans. Likewise, the Exempt Organization function monitors organizations exempt from federal income tax to ensure their compliance with statutory requirements.

A total of 2,401 average positions and \$93.3 million is requested in FY 1986 for Employee Plans and Exempt Organizations, a decrease of 21 average positions and \$2.3 million below FY 1985.

During FY 1986, resources will primarily be devoted to handling the substantial volume of determination letter applications that are expected to result from the passage of the Tax Equity and Fiscal Responsibility Act of 1982, the Retirement Equity Act of 1984 and the Deficit Reduction Act of 1984.

In the Exempt Organizations area, the requested resources provide staff to issue prompt responses to approximately 74,300 requests from organizations seeking tax-exempt status and appropriate advance assurance of deductibility.

4. INVESTIGATION, COLLECTION, AND TAXPAYER SERVICE APPROPRIATION

Tax fraud investigations

The Tax Fraud Investigations activity is responsible for investigating criminal violations of the Internal Revenue laws. The resources for this activity in FY 1986 total 4,413 average positions and \$209.4 million, a decrease of 74 average positions and \$4.4 million below the FY 1985 level.

A greater emphasis is being placed on the growing amount of activity involving illegal tax protesters, fraudulent tax shelters, questionable refund schemes, offshore banking, and tax havens. The Service will continue to commit a substantial level of resources to the special enforcement areas of organized crime and narcotics trafficking. In addition, the Service will maintain its commitment of resources to the President's Task Forces on Organized Crime and Drug Enforcement. In FY 1986, 262 average positions and \$12.3 million are budgeted for this effort.

Collection

The Collection activity has the responsibility to collect unpaid accounts; secure delinquent returns; determine and analyze why accounts become delinquent; develop and implement programs to prevent accounts from becoming delinquent and prevent nonfiling; determine and analyze the reasons for nonfiling; and measure the types and degrees of nonfiling.

The proposed budget for Collection totals 16,056 average positions and \$602.4 million in FY 1986, a decrease of 801 average positions and \$21.2 million below the FY 1985 level.

In the Accounts Receivable Program, the Service will complete action on some 3.3 million unpaid accounts and collect revenue of \$9.5 billion, an increase of \$280 million over FY 1985. In addition, the Service will collect revenues of \$7.8 billion from initial billing on unpaid accounts. The Delinquent Returns Investigations Program identifies taxpayers who have not complied with their filing requirements. The requested resources will enable the Service to secure 3.1 million delinquent returns and assess \$4.5 billion in unreported tax.

The Service successfully completed nationwide implementation in FY 1984 of the Automated Collection System (ACS), which provides state-of-the-art computer and telephone technology in order to improve office operations and to accelerate collections of unpaid taxes. The system is the initial step in a series of efforts to control increasing workload through improved productivity. During FY 1985 and FY 1986, the Service will make major strides toward automating the remaining Collection activities, including the Collection field and special procedures functions. Savings of 262 average positions and \$2.6 million from automation of these functions are reflected in the FY 1986 budget.

Taxpayer service

The Taxpayer Service activity promotes voluntary compliance with Federal tax laws on the part of all taxpayers by informing them of their responsibilities and by providing services which will assist them in meeting their obligations. This activity also provides information about Service notices and procedures and resolves inquiries concerning taxpayers' accounts.

Resources requested for FY 1985 total 4,214 average positions and \$164.3 million. A decrease of 156 average positions and an increase of \$0.1 million. The FY 1986

program provides a balanced and cost effective system for providing essential tax information to the public. Over 55 million taxpayers will be served through direct assistance or taxpayer education.

Timely tax law and account assistance through the toll-free telephone program, walk-in program, and correspondence will continue to be provided in FY 1986. Additionally, the Outreach program will provide tax law information and group tax return preparation assistance at community and business locations. The use of computer-controlled multifunctional equipment providing both tax law information and refund information will also be continued in FY 1986.

The Tax Counseling for the Elderly program will be fully funded at the FY 1985 level of \$2.0 million for grants to participating organizations.

Enforcement litigation and rulings

Enforcement Litigation provides legal advice and assistance to field Collection and Tax Fraud investigations. Support is also provided through legal services in the administrative areas of labor relations, contracting, tort claims, equal employment opportunity, disciplinary matters, disclosure matters under the Freedom of Information Act and the Privacy Act, and tax practitioner discipline.

The Rulings program accomplishes a variety of legal and technical functions which facilitate taxpayer compliance by promoting the uniform interpretation and application of the Federal tax laws.

The requested resources of 1,433 average positions and \$65.6 million in FY 1986 represent a decrease of 107 average positions and \$5.3 million below the FY 1985 level.

CONCLUSION

Overall, Mr. Chairman, our budget request follows the Administration's goal of freezing spending in fiscal year 1986 to limit the federal budget. Within this objective, we will achieve necessary reductions and cover unavoidable cost and workload increases, implement the Deficit Reduction Act of 1984, continue efforts begun over the last few years to modernize ADP systems, maintain essential levels of tax administration, and begin a major revenue initiative planned for fiscal years 1987-1989 by advance hiring revenue agents late in FY 1986. Attached are a few charts depicting key aspects of the budget.

Mr. Chairman, my colleagues and I will be pleased to try and answer any questions you or the members of the Subcommittee may have.

[EDITOR'S NOTE.—Charts attached to the prepared statement have been inserted in the oral testimony.]

Mr. EGGER. Now, Mr. Chairman, I think I would be happy to deal with the questions, and I might take the point Mr. McGrath made first unless you have some desire that I pursue another line first.

Chairman PICKLE. Have you finished your testimony?

Mr. EGGER. Yes, sir.

Chairman PICKLE. Go ahead and respond to Mr. McGrath.

Mr. EGGER. I do want to address that because it is clearly on the mind of every taxpayer in the country, and it is on my mind a lot more frequently than it is a lot of other taxpayers.

The situation that we have is a result primarily of the inability of our people working with the correspondence and the requests and the adjustments, and so on, to be able to access our system during the early months of this year. In other words, when a taxpayer writes in and questions an adjustment or says that an adjustment in the account is necessary, in order for us to verify that or in order for us to make the adjustment, it is necessary for us to access that part of our system which contains the taxpayer account information and to make the adjustment. That is all done by computer.

During the early months of this year, as the committee has already heard, that system was experiencing considerable problems

both in terms of hardware and in terms of software in those programs. There was a considerable period of time when a portion of our system, which is our data retrieval system, was not available except for brief periods of time. If we cannot access the system to get in and make an adjustment, then we cannot make the adjustment, and that was the reason for most of the build-up of correspondence.

We think we have rather dramatically improved that situation over the last few weeks, and we are in the process of trying to find the proper kind of skills to get into those centers to work down the backlog. It is not good enough just to put people in there. We have to put people in there who understand the adjustment system because, otherwise, the training and experience and so on would be next year before new hires would be effective.

So, what we are doing is going back to our districts and identifying people that we can move into the centers to assist in that.

For example, we have already moved 35 people out of the district office in Philadelphia to the center, while we are searching for additional people wherever we can find them.

Mr. McGRATH. I am questioning how prudent it is to cut back in areas where there still are backlogs.

I got a call from a person in my district who wanted to know why it takes 8 months to find out that his tax had been miscalculated. Meanwhile, the penalties and levies are accruing.

Mr. EGGER. I cannot identify the nature of that adjustment. There is no question but that we are behind in that. A lot of the build-up in correspondence is something that we identified not because of the computer problems but because we initiated well over a year-and-a-half ago the improvement in our correspondence procedure in the centers as well as in the district offices. In the course of doing that, we have centralized for the first time in some of the centers all of the correspondence as it comes in the door initially and, therefore, we have a much better count on the amount of correspondence we are receiving than we ever had before. So, a lot of that is not all of a sudden a correspondence level jump up but, rather, we are better able to control accounts.

Chairman PICKLE. Mr. Commissioner, with regard to the collection problem, we were submitted figures showing the backlog of correspondence generally in all of the ten different service centers. The figures are shown as of the end of December. Can you give this committee the number of backlog, that is, correspondence as of the latest date you can give us, either February or March?

Mr. EGGER. Yes; I have it as of the end of March and I also have some figures as of the April 12. I would prefer to give you the later figures.

Chairman PICKLE. That is late enough. Are they larger?

Mr. EGGER. No, sir, they are coming down.

In Philadelphia, for example, we had 148,000 correspondence matters open at the end of 1984. At the end of March 1985, we had 102,000. As of April 12, we have 92,000. So I would simply point out that is coming down.

Chairman PICKLE. Is that typical of the other centers?

Mr. EGGER. Yes; I might point out for Mr. McGrath's benefit, in Brookhaven, we had at the end of 1984 238,000. At the end of

March 1985, we reduced that to less than half, to 100,000, slightly over, and about 90,000 as of April 12. I am saying to you that these things are getting attention and we are achieving some results.

Chairman PICKLE. In Austin, TX, an employee of the union reported the instance of such high pressure on individuals that the only way they could get out from under was just to shred some of the correspondence. I want to assume the reduction in the number of pieces of correspondence was brought about not by any shredding going on, as has been alleged in Austin.

My question to you is does this represent unfair pressure against the employees because they are assigned work quotas? Are demands made of the employees unreasonable? Are they being given more than they can handle?

Mr. EGGER. The way we operate in the service centers is not unlike any other manufacturing or production process. In point of fact, it is a production operation. You have been in the centers and you have seen the huge volumes that are handled in the pipeline process there.

Each year, we set production standards, if you will, based on what has been achieved in the country across the board, and those standards are objectives which are to be achieved at those several different operations within the centers.

We believe those standards are reasonable. They are under review each year. In many instances, the standards that are set have been far exceeded in other centers, and so on.

Because of the concerns that have been expressed over the past few months, I have asked the staff to once again go back and take a hard look to see whether we are asking for more than is reasonable. I think we are committed to the use of production standards. I do not think there is any intention to change that, but whether those standards are in some instances too high or not, I expect to find out. If they are, certainly we are going to do something about it.

I do not relate the standards being set on the basis of budget dollars.

Chairman PICKLE. Are you saying, Mr. Commissioner, in your opinion, the work quota assigned to an individual is not unduly harsh and they should be able to handle it and you would disagree with the employee's statement?

Mr. EGGER. I would disagree with it, but I am certainly willing to review once again.

Chairman PICKLE. Mr. Commissioner, you indicated you were through with your testimony and you have not given us testimony that we want to hear. Before we go into the question period, I want you to go through briefly at least the different cuts and reductions in each of the four categories where you are recommending reduction. I want to be sure you understand that.

Will you go to that part of your testimony where you are making a recommendation of cutting.

I would assume you start on the page dealing with salaries and expenses.

Mr. EGGER. Salaries and expenses, our budget is identified in four separate budget accounts or appropriations accounts.

The first of those is salaries and expenses. This involves not only the executive direction which is my own office, but also management services which includes, among other things, research.

We propose a reduction there in the fiscal year 1986 budget of 136 FTE's, or positions.

In returns processing and revenue accounting, we propose a reduction of 239 positions. That is out of 21,000, or about a 1-percent reduction, and a small reduction in computer services of 26. So, for that particular category or that particular appropriation account, in total it is 265 positions or about 1.15 percent of total.

In examination, we have proposed an increase just slightly over 1 percent or 322 positions, and then we have proposed very modest reductions in appeals and employee plans and exempt organizations so that for the full accounting of appeals and examination, a reduction of 285 staff positions or just slightly under 1 percent.

In the Investigation, Collection and Taxpayer Service, we propose a reduction in tax fraud investigations of 74; in collection, 801; and in taxpayer services, 156; and in our enforcement litigation, 107, for a total reduction in that account of 1,138 positions which is about 4.2 percent of the total budget.

Overall, our reduction is 1,254 positions, or about slightly under 1.5 percent overall.

Chairman PICKLE. Mr. Commissioner, if your reduction is 1.5 percent, and if 1 percent represents \$1 billion, then we are losing \$6.5 billion by this reduction.

Mr. EGGER. I need to correct your understanding there, Mr. Chairman. The 1 percent that I referred to represents \$5 billion, which is a 1-percent drop in the compliance level of the tax law.

Chairman PICKLE. I want you to tell us what overall a 1-percent reduction in this staff would mean in respect to total revenue collected.

When I look at the chart put together back here for the IRS budget request, it shows here that you did have salaries and expenses, a decrease of 213. On processing tax returns, you show an overall increase in the productivity item, but in the areas of return processing, you have a decrease of 265.

On examination and appeals, you do show an increase, but that does not start, as I remember, until 1987.

Mr. EGGER. No, sir, that 322 staff positions is fiscal year 1986. It is the revenue initiative increase of 2,500 for fiscal year 1987.

Chairman PICKLE. In investigations, collection and the taxpayer service, a decrease is shown of 2,511 positions, is that correct?

Mr. EGGER. No, sir. That is the budget dollars I think you are looking at. It is a reduction of 1,138 positions overall in there.

Chairman PICKLE. In 1984, you had, in that category, an actual request of 29,627, estimated projection of 26,118. That shows to me, between those two figures, that 3,500 different positions, is that incorrect?

Mr. EGGER. What you are looking at is what our proposal initially was from the Treasury Department. As you know, Mr. Chairman, in every budget there is always a give and take, between this agency and the Treasury and OMB, and others, in which those proposals tend to get modified.

Chairman PICKLE. Let us start at the beginning.

Gentlemen, I will recognize different members for questioning.

You sent up a budget for 95,000 staff positions. The budget you have submitted to Congress requests 86,000 positions.

Now, what happened from the time you made your request until you come back with the request for 86,000? Why did you think you needed 95,000 positions to begin with?

Mr. EGGER. That included the revenue initiatives, Mr. Chairman, of 2,500 additional in exam and in other initiatives of that sort, which would have been supportive of that effort, and the decision of the administration was to defer that until fiscal year 1987, so that is the bulk.

Chairman PICKLE. Between the time you made your request, and went to OMB, and it was approved by the administration, you have actually lost 9,000 positions, roughly, from what you thought you needed.

Now, what activities, if any, would you not do under the OMB budget, that you have done in previous years?

Mr. EGGER. The great bulk of that difference is in exam and collections. It is simply a question of the level at which we would carry out those activities.

In other words, if we had more people to examine returns, we would examine more tax returns.

Chairman PICKLE. How much revenue could be brought in under your original proposal of 95,000 positions, that would not be brought in under the OMB's request? You start off saying you need 95,000, and now you have 9,000 less that you have asked for.

Mr. EGGER. In that fiscal year.

Chairman PICKLE. My question is, how much more money would have been brought in if you had gotten the staff you requested?

Mr. EGGER. About \$2.3 billion.

Chairman PICKLE. It seems to me I recall a higher figure, somewhere between \$4.5 and \$6 billion.

Mr. EGGER. Let me explain the revenue initiative, which we do have in the plan for fiscal years 1987, 1988, and 1989, which contemplates the addition of 2,500 positions for examination in each of those 3 years. The 3 year aggregate of additional revenue is about \$4.6 billion. I am speaking now only of the 1986 portion.

Chairman PICKLE. The figure \$4.6 is nearer the figure I had in mind.

Mr. EGGER. That is a 3 year cumulative figure.

Chairman PICKLE. You have 86,000 positions. Is that more or less than you had in 1980?

Mr. EGGER. It is about 1,000 positions fewer than we had in 1980.

Chairman PICKLE. From 1980, we have a growing number of people who send in their returns. I am told it is about 5 million more this year than last year. You showed us on your chart that you had a continued growth in the tax gap, from whatever figure it was, from \$29 billion to \$32 billion.

You have an increasing number of delinquent accounts, correspondence backlogs, you say they are getting less, but they are horrendous. We have a chart showing a declining percentage of tax compliance. All of these things have come along, and besides that, we have had three tax laws in 1981, 1982 and 1984. So, we have had three new tax laws that are fairly complicated.

Yet, you are asking for 1,000 employees less. How do you justify that, Mr. Commissioner?

Mr. EGGER. I believe the achievements we have reached through the use of data processing, new data processing systems, and other productivity gains have more than offset that 1,000.

Chairman PICKLE. Say that again.

Mr. EGGER. The productivity gains, basically in collection, in returns processing, and in other areas where we have applied either new procedures or new systems, has permitted us to make that improvement.

Chairman PICKLE. Mr. Commissioner, I am trying to listen and follow you, but it seems to me like you are straining to find an answer. You have greater productivity with 1,000 less employees, the tax gap is growing, compliance is getting less, we got snafued all over the country, in the service centers, and you are telling me you need less people?

Mr. EGGER. I am simply saying the rationale for having fewer people on the payroll in 1986 than in 1980 has to do with the productivity gains which we have already achieved in certain areas, such as in collection.

For instance, in collection, after we implemented our automated collection system, we were able to reduce the cost of case closings by more than half, and we are still closing more cases in collection today than we did before that system was in place, and we are doing it with 1,700 people.

Chairman PICKLE. I understand that there is a large amount of overtime being paid now to employees. It seems to me it is somewhere around \$40 or \$50 million this past year, is that correct? Whatever it is, it is a large sum. Are you getting more productivity by giving more and more overtime?

Mr. EGGER. Mr. Chairman, I need to reemphasize that this particular year is not the same as has been in the past, and not the same as it is going to be in the future. We have had a host of problems arising from having to implement a massive new data processing system in this period, and we have had difficulties. Those difficulties have given rise to a lot of these backlogs, and to a lot of the need for overtime, and we are dealing with that.

In fact, the Appropriations Subcommittee, the other day, proposed to increase our budget for fiscal year 1985, adding another \$33 million. We believe that that kind of action will be of great assistance to us in this year.

I am simply saying to you that I do not believe that you can jump to the conclusion that this year is going to be the standard for all of the years that are ensuing. We do not believe that.

Chairman PICKLE. 1985 may be an unusual year, because of a new computer system. We must understand that, and I am inclined to understand that. So that may be part of the difficulty, but we have five or six more categories not necessarily tied to computers, per se.

I find it difficult to believe that you tell me that you have great productivity and, therefore, you can have 1,000 less employees. Now you tell me that the Appropriations Committee is thinking in terms of adding \$33 million.

In 1981, we added \$38 million to the request. The administration asked for less people. Yet appropriations turned around on recommendation from this committee, and now it looks like the same process is going to take place again.

My question to you is, if you had these extra appropriated funds, would that result in more efficiency within your Department, more collections, more revenues, less collections, overhead, and the other difficulties?

Mr. EGGER. Of course, Mr. Chairman, if we had more resources, we could do a much more extensive job in training. We could increase staffs where it is indicated. Yes, it would result in both improved efficiencies, and more revenue, of course.

Chairman PICKLE. I think the purpose of this committee is to review what you have done in the last 2 or 3 years, and what your plans are for next year, and determine whether you need more personnel.

I am trying to find out if you had more money whether it would create more efficiency, and you are saying yes, it would, and I take it you are saying yes, you do need the extra funds and these new positions.

I am going to ask OMB to confirm that. I am willing to cooperate, and I want to make sure that is what you want, and not have you come up and say you are going to cut 1,000 positions, but we will depend on you to put it back in the budget. If we are going to do that, it has to be on an equal basis, and you think it would be efficient and helpful. Otherwise, you stew in your own juice.

Mr. EGGER. I think there is a definite tradeoff between the control of Government expenditures and what you can achieve with just some more dollars. That is what the administration is attempting to do, achieve that balance, Mr. Chairman.

Chairman PICKLE. I have taken too much time.

Mr. Schulze, do you have a question?

Mr. SCHULZE. Mr. Commissioner, as I understand it, your fiscal year 1986 budget is set at the same level as that enacted in 1985, is that correct?

Mr. EGGER. Yes, sir, that is correct.

Mr. SCHULZE. In your opinion, can the IRS operate efficiently and expeditiously during fiscal year 1986, without incurring the types of problems such as those which occurred in Philadelphia, Austin, and other places?

Mr. EGGER. I believe the answer to that, Mr. Schulze, is yes, we do not even anticipate or think it is possible to have the collection problem in 1986 that we had this year. We have overcome many of these problems.

We believe that by not having to go through that kind of massive change in a second successive year that we will achieve a great deal of the objectives that we set up for ourselves, in designing these systems, to begin with.

Because of the timing and the fact that we are putting three major systems in place at one time, we have experienced that. I am satisfied in my own mind that it is a temporary situation, and we will not have that problem again next year.

Mr. SCHULZE. I am afraid I disagree. I do not think you have overcome this problem. If my district office is any indication, we

have had literally thousands of phone calls from people who are concerned that something has happened to their return, because they have not received a refund.

I would say your problems are expanding. I am quite concerned. I am concerned that there are a lot of problems out there you may not know about personally. I am afraid these are indications of a lack in communications somewhere along the management level. Some think the problems are too minor, and they are going to take care of themselves.

I have the feeling that this is the tip of the iceberg, and it scares the devil out of me. Can you assure us that this is not the tip of the iceberg? I realize that it is difficult, but is there any way you can assuage our feelings?

Mr. EGGER. Let me assure you I will not be aware of every problem in the IRS, with 700 locations around the country. But I am satisfied in my own mind. I am embarking on a series of field trips to meet directly with not just the Regional Commissioner, and District Directors, but I am talking about the people at the unit management level, as well.

Last week, in Philadelphia, I had an opportunity to speak to all 2,000 people working up there in the center. I intend to continue to do that, to make sure that some of the things that we have seen happen, is not what the Internal Revenue Service is about, and whether somebody believes it is due to work standards, or that they think there is some personal gain in it, that kind of thing will be totally unacceptable.

It is true that you and we, and the newspapers and everybody else are getting a lot of telephone calls. But I would like to show you a chart of what has happened to us just in phone calls this year, and explain what type of problem it is for us, in attempting to cope with what is happening. [The chart appears below.]

Mr. SCHULZE. It seems to me you are changing the system. Whoever gets that phone call is a generalist, rather than a specialist. Is that correct?

Can they answer any questions to assist the taxpayer?

Mr. EGGER. Our procedure is this, the individual who receives the call has had training on a wide variety of tax matters. The idea is that that individual who receives a question which he or she cannot answer, they are required to transfer that call to someone who does have the knowledge and the ability to answer that question. To the extent that that does not happen, and it is not in keeping with our procedures, we monitor those calls, to try to see that, No. 1, the taxpayer is getting the correct information; and, No. 2, that the recipient of the call is following the procedures.

While there can be cases where that is not true, again, I said it is not in keeping with our proposals.

Mr. SCHULZE. I understand the IRS employees who answer the phone are not authorized to settle a problem, is that correct?

In other words, if someone calls and says I have received a check which I do not believe belongs to me, or I received a check for \$10,000, and I do not deserve it, the individual on the phone is not authorized to say, "send it in, and I will straighten out the account."

Mr. EGGER. That is correct. They are simply to provide information. They are not trained to deal with calls like that, and they should immediately be referred to someone else in the organization who is.

Mr. SCHULZE. Are you satisfied that those things are being handled efficiently? In my opinion, they are not being handled efficiently. It seems to me there has got to be a better way to handle these matters, for instance access to the computer. IRS employees could verify quickly the inquiry, and if the IRS has erred, the employee could put a stop or hold into that computer.

Why would that be extremely inefficient, or is that where we are going with the new computers?

Mr. EGGER. It is not possible to do it in that sense. We handle well over 50 million phone calls, and the number of people involved in dealing with relatively unsophisticated questions simply do not have the training, nor do we have them on board year round to deal with the more complicated problems.

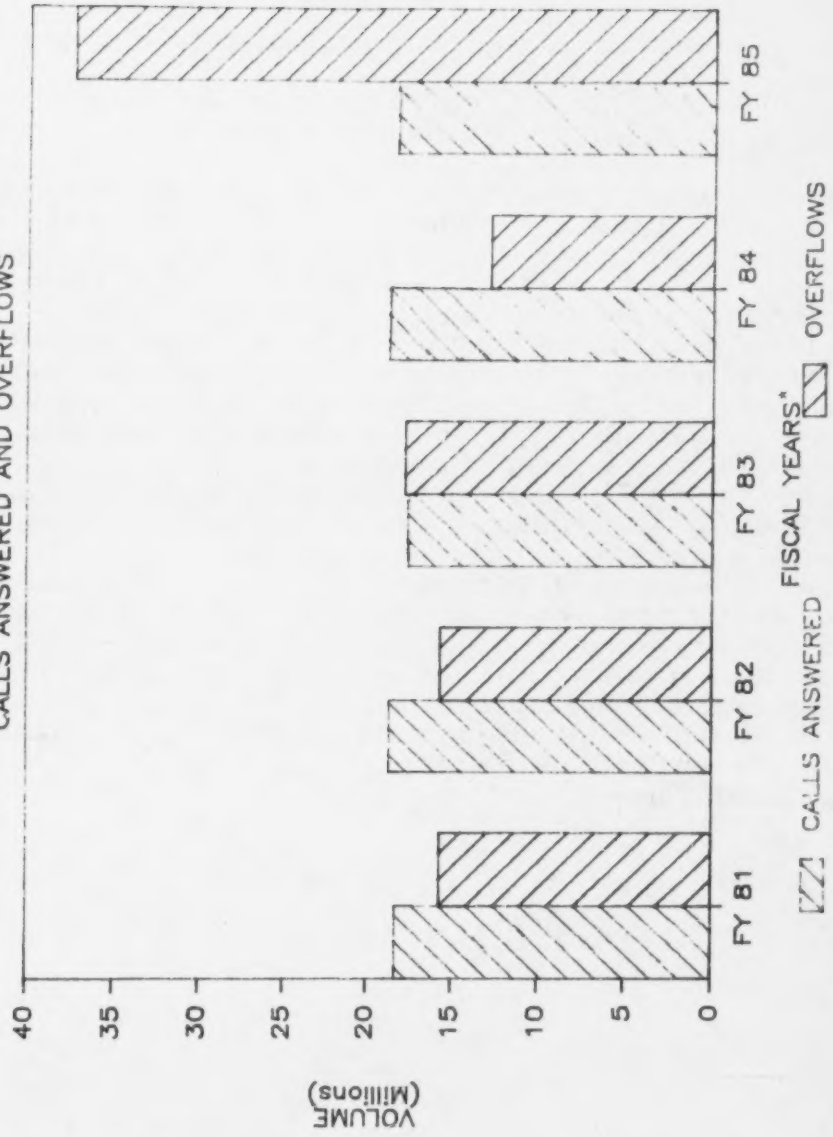
I do not think it is possible to have every one of those people on the telephone answering call sites to be able to have access to the taxpayer accounts, and make corrections, so on.

Mr. SCHULZE. Mr. Commissioner, it is going to be difficult to encourage people to write in, in light of the correspondence backlogs. If someone came to me with a problem, I do not know that I would say sit down, write it out in length, and it will be taken care of. Then they are contributing to the backlog.

Mr. EGGER. I would like to point out what is happening here in the telephone business this year.

[A chart follows:]

FILING PERIOD COMPARISON CALLS ANSWERED AND OVERFLOWS



* Weeks 1 - 15

Mr. EGGER. In all of the years, from fiscal year 1981 through fiscal year 1985, those blue bars represent the number of calls that were, in fact, answered by someone in the Internal Revenue Service.

The red bars represent overflows, or busy signals, if you will, in other words, our computer identifies each call, where the caller gets a busy signal. We do not know if that individual called six times or one time.

But look at what happened to us in fiscal year 1985. The number of calls in the aggregate has gone up dramatically. As a consequence, instead of being able to deal with it as we did in fiscal year 1984, where we answered some 83 percent, we have responded to some 83 percent of the taxpayers who called in. This year it dropped down 10 percentage points, so we are down around 73 percent.

Therefore, the total number of calls and the taxpayer frustration with having to call three or four or six times to get into the system is what is reflected in fiscal year 1985. That is due to the problems that have surfaced, and the publicity of those problems have gotten, that have frightened people, such as telling them that thousands and thousands of tax returns were being shredded, and there is no evidence of that.

They call up and say, "my goodness, is my return one that got shredded," et cetera, et cetera. We have enough problems without that, to be honest with you.

Mr. SCHULZE. In your opinion, Mr. Commissioner, if you had it to do over again, would you phase in these new computers in a much more gradual way, or would you have put a couple of thousand additional employees on to handle the shift period?

In retrospect, how could we have better phased in this new system?

Mr. EGGER. In the ideal world, when you bring a new computer system into place and you replace an old one, you hope to run the two of them parallel for some period of time. In our case, due to the giant size, it would have been literally impossible for us to both reprogram from 1984 to 1985, and at the same time. To do that both in the old assembly language and in the new COBOL language.

At the same time, we are trying to write 1,500 programs from the old language to the new language. I do not think it would have been possible to do it, even given the resources. I do not think it would have been possible to do it.

I think we had no choice, except to do as we did. The problem arose in the 1970's, when this was an opportunity to put a system in place in an orderly way, and we had to play catch up, so there we are.

Mr. SCHULZE. Let me go back to the tip of the iceberg.

Since the Austin revelation, have you taken any steps to make sure that your service center people and field people inform your office, or responsible persons in the national office of major and/or minor disasters?

Mr. EGGER. Yes; as I said before, I am making a personal visit to each of the service centers. The first such visit was in Philadelphia just last week. I am having discussions with managers at all levels,

emphasizing the need for that information to be immediately surfaced up the line, so we can be aware.

Mr. SCHULZE. Is there a mechanism where they can do that, or is the mechanism already in place, and it simply has not been utilized?

Mr. EGGER. That is correct. It simply has not been utilized.

More importantly, what we are trying to do now is to take a number of steps to emphasize to everybody in the Service the need for quality as well as the need for efficiency.

We have been in our strategic planning process since last year wrestling with this whole problem of how do we get the optimum of efficiency without a sacrifice in effectiveness, and the effectiveness translates into quality, which is what we certainly aim to achieve.

Mr. SCHULZE. I was going to ask you a question about the production standards, but I will not do that now. It seems to me that is very important. I have heard stories of pushing too hard. You are reevaluating that.

I would hope that you would share with this committee the benefit of that reevaluation, to reduce the workload or pressure a little bit, so to realize a little more efficiency.

As I understand it, Mr. Commissioner, if we were to appropriate funds for you to hire an additional 5,000 employees this year, fiscal year 1986-87, you would use these employees entirely in the enforcement area, and not in the taxpayer service area, is that correct?

Mr. EGGER. Given our priorities, that is probably where we would place the bulk of the resources. I believe, personally, that the system itself is not monitored to the level it should be.

Our exam level is too low, so that would be a priority in my mind. It does not mean we would fail to take into account other areas, particularly in the taxpayer service area.

Mr. SCHULZE. With the current backlog, would it not be helpful to get some additional personnel, even if it is for a year, or 18 months, to get these backlogs out of the way. Has this been considered since you are in the process of reevaluating production standards?

Mr. EGGER. It would be, but as I tried to point out, it is not good enough to simply put on more people. Let me take the correspondence adjustment branch, which is one of the areas where we are concerned right at the moment. Those people in that branch are among some of the most technically competent people in the entire Internal Revenue Service. It takes years to develop that kind of competence, and say OK, we will take somebody from somewhere else and put them in there, and get the backlog down. That just does not work. We are doing that. We are bringing people out of the districts who have the kinds of backgrounds that will permit them to do that kind of work, and we are doing that around the country in an effort to reduce those levels.

But it takes that kind of training, and you cannot simulate that. You cannot simply give someone a weekend of training and put them in there.

Mr. SCHULZE. Can you give this committee some kind of assurance that within 6 or 9 months, or within some particular time-frame, the correspondence build up will be reduced?

Mr. EGGER. Most of the centers believe that within the next few weeks, literally, that they will have most of their backlogs down to an acceptable level. You will never eliminate it, of course, but there are some centers, and Philadelphia is one of them, where that may not be possible.

In my visit up there last week, I asked the regional commissioner to go to every one of the districts in his region, and further identify people who have the qualification and training and know-how, to bring them into the Center, so we can do just that. I do not know how long it will take. I cannot sit here and tell you that, by the July 1, for instance, that we will have it down, until I can see how many people we can identify, get them in there, and see how effective they are.

Mr. SCHULZE. Do you think acceptable levels can be reached by the end of the year?

Mr. EGGER. I would hope before that, well ahead of that. I cannot wait until the end of the year.

Mr. SCHULZE. Mr. Chairman, I have consumed a lot of time. I yield back to the chairman.

Chairman PICKLE. I will have to ask the members now to stay within 5 minutes.

We asked you a question in writing, and in response, you replied.

We asked you first, how would the Service allocate additional staffing at each of the following staffing levels; 1,500, 3,000 and 5,000. You replied to us, on examination, 500 more people, it would cost you \$26.3 million; and you would ultimately collect \$277 million, a yield of 16 to 1.

If you had 1,500, it would be \$79 million, and you would collect \$546 million, and the rate of yield would be 7 to 1.

If you had 3,500 people, you would break it down to 25 for 200,000 return, and you would have a ratio of return of about 21.9, when you add them together. You would collect over \$1 billion.

If you had 5,000, you show the ratio of about 16 to 1.

Now, Commissioner, you responded to us that if you had these extra staff, that this is where you would put them, and this is the ratio of the money you would bring in. Is that a fact?

Mr. EGGER. That is the way we responded to that, Mr. Chairman, because I think that is where the priorities are in the tax administration load.

Chairman PICKLE. But you tell me you do not need any more people, but if you had them, you would save this amount of money?

Mr. EGGER. Yes, sir, you asked us where we would put those people, if they were assigned to us.

Chairman PICKLE. And what kind of revenue they would bring in. I want the record to show that.

Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

Mr. Commissioner, let me see if I understand what you are stating.

But, before I do that I would like to ask one preliminary question.

Will your employees be affected by the 5 percent pay cut that is proposed in the budget?

Mr. EGGER. Yes, of course, yes, sir.

Mr. ANTHONY. Throughout your testimony, which touches on each function, you indicate that there would be a tremendous increase in the workload. Is that correct?

Mr. EGGER. Essentially, that is correct.

Mr. ANTHONY. Is there any category that will not have an increase?

Mr. EGGER. At the moment, I cannot think of one.

Mr. ANTHONY. In summary, then, you are going to pay your employees less money, you are going to give them more work, and you are going to expect them to make up the difference in productivity.

I want you to define, and I want you to give me the name of the person who is going to instill this tremendous amount of loyalty, that will persuade your employees to work harder, and do more than they have done in the past.

What is the productivity saving? I do not want the number. Just say I am an agent out there working. You tell me I have a desk with paperwork stacked up like this, and I say, Boss, I have already gotten this far behind. Then you cut my pay 5 percent. I am a little behind in my car note. You are going to give me another 100 cases. My wife wants me to come home and take the kid to the baseball game.

Where are you going to get this productivity gain?

Mr. EGGER. The kind of productivity we are talking about results from system innovation, and from reductions in the programming in some cases.

Mr. ANTHONY. Do you have productivity innovation in the field?

Mr. EGGER. Certainly. We have improved the number of units that we get out in the course of a period of time.

Mr. ANTHONY. What does your testimony reflect the carryover inventory will be in the appeals process?

Mr. EGGER. I cannot answer that question right now.

Mr. ANTHONY. It is a little over 17,000.

You are telling everybody they are going to get a 5 percent pay cut, and at the end of the year, they will have 17,000 more cases to work on, than they worked on before. Yet, you are going to tell this committee, and all the other taxpayers who want to voluntarily comply, that you are going to be able to identify the tax cheaters. I must tell you I am perplexed.

It reads good, and it sounds good, but I want to see how you can transfer this off a piece of paper, into real life, because I do not think you can do it.

I manage a few people in my office, and occasionally, we get behind on the workload. I cannot get any more productivity out of them if I give them 150 more letters to answer over the weekend, and at the same time, tell them I am going to give them a 5 percent pay cut. It just does not work that way.

I am telling you the real world does not work that way. I am terribly disappointed in your budget proposal. When you show your charts and graphs, it appears to me you have gone out and hooked yourself on them.

Voluntary compliance has gone down. It has gone down because you have decreased the ability of the Service. Otherwise, the numbers would not be there.

Mr. EGGER. I do not agree with your conclusion.

Mr. ANTHONY. It is obvious that you do not agree with my conclusion.

Mr. EGGER. What we are talking about is not everybody is going to get a bigger stack on his desk. In many instances, we have had increased productivity in the use of improved technology, and so on.

As far as the tax staffing is concerned, that has been happening over the last 20 or 25 years. That is nothing new. It is not enough just with the way this particular administration has put the budget together.

If anything, I would expect when we get the 1982 figures to see that we have been able to slow down that trend.

Mr. ANTHONY. If the chairman would be tolerant, I have a couple of other areas I would like to discuss.

What are you going to do about the inventory of 17,400 cases as a result of legislation, of abusive tax shelters? If you are going to have a boss looking over your inventory, with a backlog of 17,000, and fewer personnel to get rid of that backlog, how is the service planning to reduce that backlog?

Mr. EGGER. I am just not able to respond to your question, Mr. Anthony, because I do not know that we are going to have 17,000 additional cases. I am not sure where that information comes from.

Mr. ANTHONY. I am going by your testimony. If you could respond when you find out, it would be helpful.

On page 12 of your testimony, you say you are going to have improved productivity in subsequent years, if you can postpone the hiring of these 2,500 additional employees.

I think Mr. Pickle made it extremely clear for the record that the sooner you have these employees, the more money you are going to be drawing in.

Mr. EGGER. I would agree with that.

Mr. ANTHONY. What is the rationale for postponing it? You are saying you are beginning to hire revenue agents in late 1986. That is September of 1986.

Mr. EGGER. Our expectation is to try to bring on board some of the June graduates so, No. 1, we get a better selection of the universities and colleges, than if we wait until September or October, and also, that we can give them a few months of training.

Mr. ANTHONY. What about the June graduates of 1985?

Mr. EGGER. The same thing.

Mr. ANTHONY. Are they less qualified?

Mr. EGGER. No, indeed.

Mr. ANTHONY. Why do we not hire the June graduates of 1985?

Mr. EGGER. It was the decision of the administration to put a freeze on spending.

Mr. ANTHONY. Why do we not tell the administration a freeze is not worth it? Why do we not tell the administration sometimes a freeze works to the detriment of the deficit? Why do we not tell the administration they are wrong in some areas? Why do we not ask for some help?

The record so far is replete. I cannot imagine that David Stockman would not agree we ought to move this up. It seems like this committee should be helping you; pushing you on OMB. Maybe we ought to educate them that the freeze hurts the deficit, rather than helping it.

While my tone may sound antagonistic, I am here to try to help you. I can tell you that, but listening to your testimony, reading the newspapers, and watching the television, where some poor taxpayer lives in a \$50,000 home, and gets docked for \$2 million in back taxes. That problem has not been solved yet, but it should have been solved within 24 hours.

I can understand why the compliance rate goes down.

I am speaking for an awful lot of taxpayers who are aggravated, so it is passing through my body to you.

Chairman PICKLE. Mr. McGrath.

Mr. McGRATH. I thank you, Mr. Chairman.

I am intrigued by your chart on the telephone calls. The number of phone calls that you take, or the number representing an overflow is over 50 million. When you consider there are only 100 million returns filed, that is an incredible ratio of phone calls to returns.

Mr. EGGER. I do not assume, Mr. McGrath, that the number of phone calls represents the number of taxpayers. We know some taxpayers have little automatic dialers, where they dial every 5 seconds for the next 10 minutes. We do not know how many of them would be taxpayers.

Mr. McGRATH. Maybe some of them have their accountants and attorneys calling, too.

I am gratified that the backlog in Brookhaven has been reduced to 96,000. What does IRS consider an acceptable level of correspondence backlog?

Mr. EGGER. That will vary from center to center, but clearly, what we want to achieve is the ability to close each taxpayer issue within 30 days. That is our objective. So no taxpayer has to wait longer than 30 days to have an answer to this very issue. Many of them we know can be closed in a much shorter time, but our overall objective is to achieve a 30 day turnaround time.

Mr. McGRATH. Would this reflect the number of returns area, or written correspondence in that area?

Mr. EGGER. I am sorry, I did not understand your question.

Mr. McGRATH. I can understand that normal levels of correspondence vary depending on the service center. Brookhaven is a larger center.

Again, I can understand the gross number of outstanding correspondence there, appears higher than somewhere else.

Is the acceptable level of outstanding correspondence determined by the amount of incoming correspondence?

Mr. EGGER. Yes. We know at each of the centers about how many issues can be handled in a 30 day period. We are about 135,000 or so over that, countrywide at the moment. We hope to bring that down.

Mr. McGRATH. Regarding Mr. Anthony's question concerning the need for additional employees, as opposed to your thesis that IRS can achieve better productivity and better systems management,

and better computerization without additional manpower, let me ask you this.

Is there a point of little return, where an extra expenditure of money, and an additional number of personnel does not drive the revenue up to a point where it was perhaps before?

Mr. EGGER. In the exam category, which is our largest revenue producing enforcement effort, yes, there is a time when that would come down to about 1 to 1, a dollar of revenue for a dollar of expenditure.

As near as I can tell, we would probably have to be somewhere, or something like an additional 75,000 revenue agents to do that, and I do not think I will live long enough to be able to absorb that many.

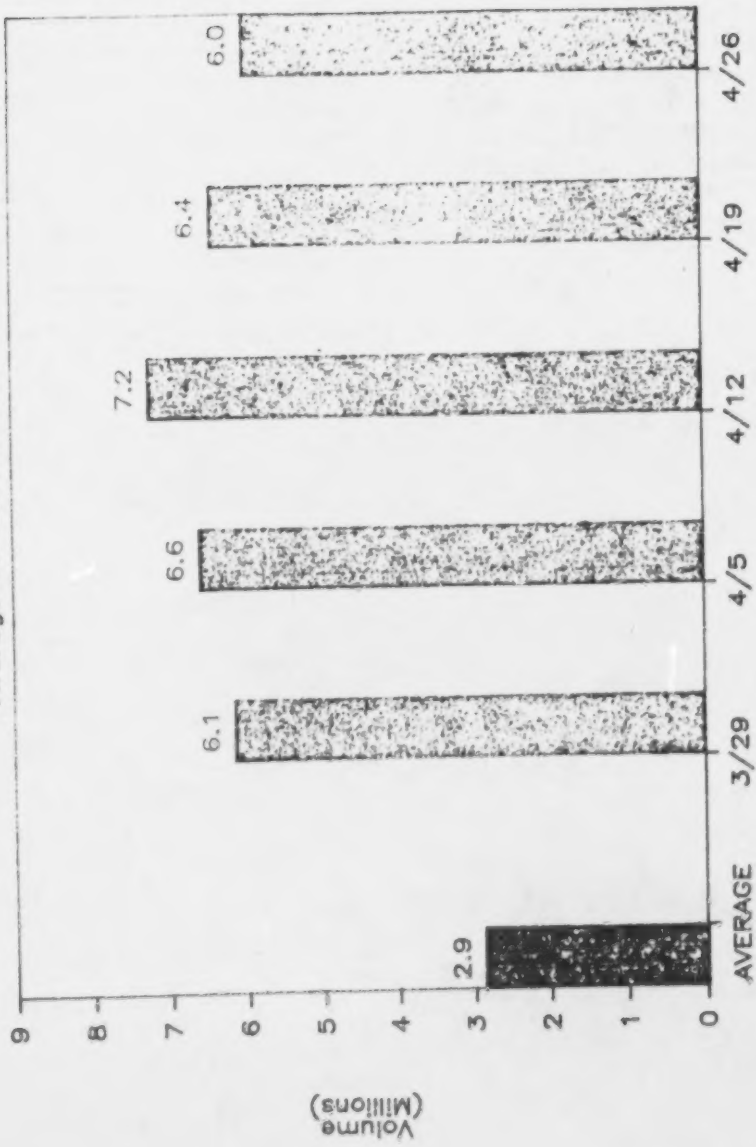
Mr. McGRATH. We are nowhere near that point of no return?

Mr. EGGER. That is correct.

[A chart follows:]

Comparison of SC Processing

Average vs. Last five Weeks



Mr. EGGER. If I could briefly refer to this last chart, Mr. Chairman, it does go to the subject of a lot of the discussion here today.

The red line over on the left indicates the numbers in millions of returns that we were processing in the centers during the period from the first of January through the 22d of March. That was an average of about 2.9 million returns per week.

Since then, as you can see, in the last 5 weeks we jumped up to 6.1, and 6.6, 7.2, 6.4, and we are back down to 6. Those figures are in excess of any week of processing in any year prior to 1985. I just wanted to show that to make my point that we believe the system we have in place, once we finally got the bugs out of it, will really help the production process.

Chairman PICKLE. We hope so, Mr. Commissioner.

It seems like this year was worse than last year. If we don't make improvements, it would be even worse.

Mr. Guarini.

Mr. GUARINI. I hope we do not kill the goose that lays the golden egg.

The questions of my colleagues would apparently seem to indicate that they have some question of credibility about your position. All of them are rather surprised at what is being said here, because it is almost contrary to logic.

I note in the last 10 years, according to the GAO report, the examinations are steadily up, 11 percent. Collection of delinquent accounts has steadily risen to 183 percent of what they were in 1976.

Delinquent accounts have steadily doubled to a 100-percent increase, and returns of compliance have fallen steadily down, from 96 of what they were in 1976.

Criminal investigations are down 24 percent of what they had been. On information returns, the workload has climbed steadily up to 126 percent of what it was.

Returns and processing have moved up 45 percent more than what they were 10 years ago. Everything shows compliance is down, workload is more.

The protesters and the returns that are being filed, not protest returns, but there are more abusive tax shelters, and more foreign tax havens, which people are utilizing to reduce their taxes, and then you come in and say we have to cut back. It just does not make good sense. I have problems fathoming exactly your position.

I understand the freeze. I understand cutting the budget, but not to the point where it will be of a diminishing return to the U.S. Government.

Of all these people, you admit that there are less resources that we have now for collections? Is that true, that you intend to cut out the investigation and taxpayer collection service by 1,108 persons?

Mr. EGGER. That is correct.

Mr. GUARINI. Even though investigations and taxpayer services are a greater problem than they were in the previous year?

Mr. EGGER. The 800 positions we are taking out, are more an offset arising from the automated collection system we put in place last year.

Mr. GUARINI. What hard data do you have that enforces that, when every curve is in the other direction?

Mr. EGGER. I have not seen that report. I have read about it, but I have not seen the report that says we are down in all of those areas.

I could not understand your criminal investigations example, but I can tell you, yes, we are auditing fewer returns today than we did before, and I have already said that, in my judgment, we are not doing enough of that.

Mr. GUARINI. The report which I read was the report which will be testified to by Johnny Fince, Senior Associate Director of the GAO, who will follow you. So those statistics are available to GAO. These are hard statistics.

From where do you derive your hard statistics? What is the basis of your information so that you can assure us that what you say is correct, and not just an estimate?

Chairman PICKLE. Mr. Commissioner, I will ask for a short recess. The House has a vote, and we have to go to the floor immediately, but we will have a recess of approximately 5 minutes.

Mr. Anthony will be back to resume the questioning, so the Chair will declare a recess for 5 minutes.

[Short recess.]

Chairman PICKLE. The subcommittee will resume its hearing. I am going to recognize Mr. Guarini for additional questioning since he got cut off short when the vote had to be recorded.

Mr. Guarini.

Mr. GUARINI. Thank you, Mr. Chairman.

Commissioner, right before we had a temporary adjournment, we posed a question as to the basis of your information, what you consider to be the hard information you have available to justify your feeling that we do not have to have more people in Investigation, Collection and Taxpayers Services?

Would you please give it to me?

Mr. EGGER. Let me deal with the investigation.

Mr. GUARINI. First, did you make a study and is the study available?

Mr. EGGER. Pardon me?

Mr. GUARINI. Did you make a study and is the study available to us?

Mr. EGGER. I do not have a study but we can certainly supply you with our own analysis.

Mr. GUARINI. All right.

So, therefore, there is no study that you made concerning the lower range of 1,138 people from the positions of Investigation, Collection and Taxpayers Services?

Is that correct?

Mr. EGGER. Well, we have all of our budget background. That certainly—

Mr. GUARINI. No. I assume that you do. But you never made a study, an organization study as to exactly what your needs are. You have gone through the budget process.

Mr. EGGER. Right. And that is aimed at identifying the needs in terms of resources. That is exactly what it is about.

[The following was subsequently received:]

ANALYSIS OF REDUCTIONS TO INVESTIGATION, COLLECTION AND TAXPAYER SERVICE

The reduction of 1,138 average positions to the Investigation, Collection, and Taxpayer Service appropriation consists of reductions in the Tax Fraud Investigations (-74 average positions) Collection -801 average positions), Taxpayer Service (-156 average positions), and Enforcement Litigation and Rulings (-107 average positions) programs.

Portions of the reductions are attributable to productivity savings (-273 average positions), reductions in administrative overhead (-253 average positions), nonrecurring of limited duration staffing allocations, including the FY 1985 Congressional add-on to this appropriation (-204 average positions), and transfers to other appropriations (-202 average positions).

FY 1986 program reductions will result in a loss of \$165 million in eventual revenue collections. This loss results from the requirement to absorb mandatory cost increases. However, it should be noted that revenue from collecting unpaid taxes and securing delinquent returns will increase by almost \$400 million over FY 1985. This is due to improved productivity resulting from investments in ADP and systems modernization, specifically the Automated Collection System, and from revenue collected due to an increasing volume of delinquency notices.

Mr. GUARINI. All right.

What criteria did you use? Was there any known criteria or was it just whatever whim that you had when you sat down because budgets are numbers and you can do anything with numbers? Was there an established criteria within the IRS Department as to how you would hire more or discharge investigation people, collection people and people in tax services?

Was that just your judgment or was there a criteria that you have within your department concerning the operation of these particular departments?

Mr. EGGER. No, Mr. Guarini. The budget process is very, very detailed and involved. Every single function reviews the workload, they review their staffing. They review every aspect of that particular function.

In examination, for example, we have a computer based model which is a staffing model. And we review not only what we need in the way of people in the field, but support people and all the rest. We get a tremendously involved look see by everyone in each of the functions.

Mr. GUARINI. Now, is this a purely objective study or do you take the guidelines that are given to you by the Department of the Treasury? If they say freeze, do you then use that as your standard, and that is what you have to comply with? Or do you use your judgment as a professional?

Mr. EGGER. The Treasury review follows our study. That is the budgetary process.

Mr. GUARINI. And they set for you the criteria under which you should operate?

Mr. EGGER. They review our budget and make their own judgments as to the basis upon which—

Mr. GUARINI. And whether you believe it or not, you must go along with that particular judgment that they made, not that you made professionally, is that correct?

Mr. EGGER. Certainly. The Treasury Department and the Office of Management and Budget always make judgments about ours and every other budget in the Federal Government.

Mr. GUARINI. So if there are fewer resources for collections, and you know that your report shows that accounts receivable are

growing and collection inventories become higher all the time, if Treasury comes in and says I am sorry, Commissioner, but you have to cut back your employees, you just get out your budget process and you just cut in order to meet their standards, is that not really what is happening in this particular case?

Not that you believe it, but that it is your position as the Commissioner to present it, regardless of the logic of it.

Mr. EGGER. First, I need to remind you that budget decisions get made almost 2 years before the circumstances occur. And in the case of Collection, for example, at the time we were developing the 1986 budget, our delinquent accounts were not growing at anything like the rate that they had in the earlier part of the 1980's. And we have achieved significant improvement in both. We have collected more dollars than we have before. We have frozen more accounts.

Mr. GUARINI. And you have less compliance. You have a bigger gap in payment.

Mr. EGGER. Compliance is something that is not attributable solely to tax administration. It is also attributable to the nature of the Tax Code and the perception of people about the fairness. All of those things are factors that enter into compliance.

Mr. GUARINI. Did not your own procedure call for an increase of 7,500 people over a 3-year period, and what you are really doing is trying to move it because of the freeze to 1987 in defiance of what your original judgment was?

Mr. EGGER. Right.

Mr. GUARINI. Well, is that not contrary to all logic? All you did was just go along with what the freeze was.

You know, if all the people, our Chiefs of Staff had said to President Johnson at the time of Vietnam—and this is the 10th anniversary of the fiasco that we had there—and told him exactly what it was like in the field, and the strategy was not working, we might not have had the disaster and tragedy we had in Vietnam.

So I am asking you is there anything that you think that we could do other than freezing? Are there any other suggestions that you could make where we could become more efficient?

You stand on your testimony. I understand you will not change it. But I just want you to see the illogic of what is being presented. We spent a lot of money for training of people who are going to be let go. We give more and more examination help in tax services today than we have ever given before, and at a time when people say that the code is unfair, unequitable and not simple enough, it seems to me that we are going in the wrong direction.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Commissioner, we have another vote scheduled. This may be a day of games over on the floor. I hope not, because we have several more witnesses we want to hear from immediately. And we will continue right on through the lunch, let me add.

Let me ask you two or three questions before we break up.

Looking at the trend in your examination policy over the past few years, there has been a steady decline in the percentage of returns audited.

Now, does this mean that you and the IRS feel that there has been a decline in the number of returns which would be found deficient if audited?

How do you accept the fact that you are having a decline in these audits?

Mr. EGGER. OK. To begin with, the audits that we are doing today are not necessarily totally comparable with the audits that we did 5 or 10 years ago. Let me explain.

For one, our ability to identify a return which has the likelihood of error and need of correction is significantly greater today than it was, let us say, in 1974. For example, our no change rate, and that is to say the number of returns that we selected for examination where there was no change, was about 28 percent in 1974. It is down now to 16 percent. So that the number of returns that we select for examination today have a much higher probability of correction than they had in 1974.

We are also auditing more complex returns today than we did at that time. In other words, it takes longer to audit those returns and, therefore, we can audit fewer of them with the same manpower.

I have already said that over a period of years since 1980, we have increased across the board our enforcement personnel by about 13 percent. But Exam, unfortunately, has only been increased by a third of 1 percent. And I have said over and over again that I feel that Examination is the area that has the high priority, and it was for that reason that I proposed for this year to embark upon the 3-year program that I have identified.

Chairman PICKLE. Then you are saying that the audit returns of 1.2 percent projected for 1986 is just as good as the audit returns we had in 1980 of 2½ percent?

Mr. EGGER. No, sir. I am simply saying that those two things are not necessarily totally comparable. That is all.

Chairman PICKLE. Well, now you made——

Mr. EGGER. I have already said and I——

Chairman PICKLE. And technically explained that.

Suppose we had an auditing number now of 2 percent, 3 percent, 4 percent. What additional revenue would that bring in?

Mr. EGGER. I do not have the numbers but it would be a lot.

[The following was subsequently received:]

INCREASED EXAMINATION COVERAGE RATES

Examination is constrained in the number of additional staff-years it can effectively recruit, train and absorb in one year. Currently this number is approximately 2,500 additional staff-years for FY 1986. Were we to add this number of staff-years every year between FY 1986 and FY 1989, Examination would achieve about 1.9% coverage in FY 1989 and about 2.0% in FY 1990. The increasing number of tax returns filed each year along with expansion constraints impede Examination's ability to substantially increase coverage over a period of just a few years.

The additional returns examined by the increased staffing would result in about \$4.6-4.7 billion in additional tax, penalties and interest collected in FY 1986-FY 1988.

These estimates are predicated on (a) the additional 2,500 staff-years for FY 1986 and subsequent years being on board October 1, each year, and (b) full implementation of Examination ADP initiatives designed to substantially enhance productivity.

Chairman PICKLE. I think it would be good for us to have that. Surely it would follow the more returns audited, probably the more revenue you are going to get in.

Mr. EGGER. We pointed that out in our revenue initiative for 1983, which had only 1,000 positions for examination that we achieved significant improvements there. And we propose the same thing for 1986. And in the balancing of the budget proposals by the administration, their conclusion was to defer that for 1 more year.

Chairman PICKLE. Well, I find myself being a little confused here.

You say our problem is unusual this year because of the change-over to computer.

Mr. EGGER. Yes.

Chairman PICKLE. And yet we do not need all these more people because we are getting greater productivity by virtue of having less people? Now, you cannot have it both ways, Commissioner.

Mr. EGGER. Those two things are not comparable. The facts that we had problems this year happen to do with the—

Chairman PICKLE. Well, they are not comparable but you say they are related?

Mr. EGGER. I would say that the problems we have had this year that have been referred to in this hearing are not the problems that I foresee in the enforcement area. They are quite different. They are unrelated.

Chairman PICKLE. Well, Mr. Commissioner, I am like Mr. Anthony. I am trying to be of some help to you and—

Mr. EGGER. I appreciate that.

Chairman PICKLE. And I do not say that you are stonewalling it but I am struggling to understand the degree of straightforwardness that you are displaying.

In face of all these figures, your examinations have got a little increase but audit coverage was dropped to an all time low of 1.2, and you tell me that is good.

You wanted additional personnel, examination personnel, but OMB postponed a lot of that until 1987. There is a decrease in returns processing which could mean as much as a loss of \$45 million. Computer services positions are being cut. Collections are being cut by some 800 positions. Taxpayer services are being cut. Training was being cut.

Now, Mr. Commissioner, in the face of all these reductions and only one increase really, and that is examination, you must ask yourself what can be done. And you do not go forward by taking four steps backward. And something has got to be realistically looked at on this thing.

So I alert you, we are going to submit you a lot of questions that we want immediate response to before we go to the Appropriations Committee and ask that any action be taken.

Now, before I leave this subject, I want to ask you two questions with respect to the Austin situation.

They had a case of shredding down there. Do you know of other shredding incidents that have happened over the country?

Mr. EGGER. We have asked for a second review by all of the regions of the service centers in their activities. And I have not—I just got those in in the last couple of days.

Chairman PICKLE. Do you have any regulation now that says to the District Director, wherever these services are, if you have evidence of shredding going on in your office, unauthorized shredding, that that is supposed to be reported to you?

Mr. EGGER. Yes, indeed.

Chairman PICKLE. And then in any service center where that has been going on and they have not reported to you, they are in violation of your regulations?

Mr. EGGER. Well, I have issued those instructions since rumor that came out in the press about shredding of tax returns in Philadelphia. And we still have not found out about that. So I have asked all of the field to go back and review and report to me those incidents. And Austin is the first one that has come to my attention.

Chairman PICKLE. I have run into a problem in the Austin center that may be typical of others, and that is a lot of my employees are claiming that they have not been paid for work they have done from January up to date, that there is a big backlog of checks or lack of checks being issued in the Detroit Payroll Processing Center. And some said that they have not gotten their check or that it was very late, very delayed, and some have even left the center and that they do not even know how to find them.

Have you had this reported in other district offices?

Mr. EGGER. Yes. We do know of a backlog of adjustments to salary accounts, and that could include overtime as well as other adjustments such as amending the amount of insurance——

Chairman PICKLE. Well, what steps are you doing now about the Detroit office?

Mr. EGGER. We have allocated additional resources to the Data Center for the purpose of overcoming that.

Chairman PICKLE. Do you need more manpower out there?

Mr. EGGER. We have done that. We have already put it up there.

Chairman PICKLE. Well, is that problem corrected or is it being corrected?

Mr. EGGER. It is being corrected.

Chairman PICKLE. Then any employee who has worked ought to be able to get their check almost immediately.

Mr. EGGER. I agree with that.

Chairman PICKLE. Will you be able to beat the deadline on the processing of all these returns before the May 31 deadline on refunds?

Mr. EGGER. I want to answer that but I also want to be clear that we have always—this is not just this year, but in every year we always have a number of returns that are unprocessable. They have errors or they unpost or there are other reasons why we cannot process the return. Except for those, we will be able to meet the deadline on all of the returns that are processable.

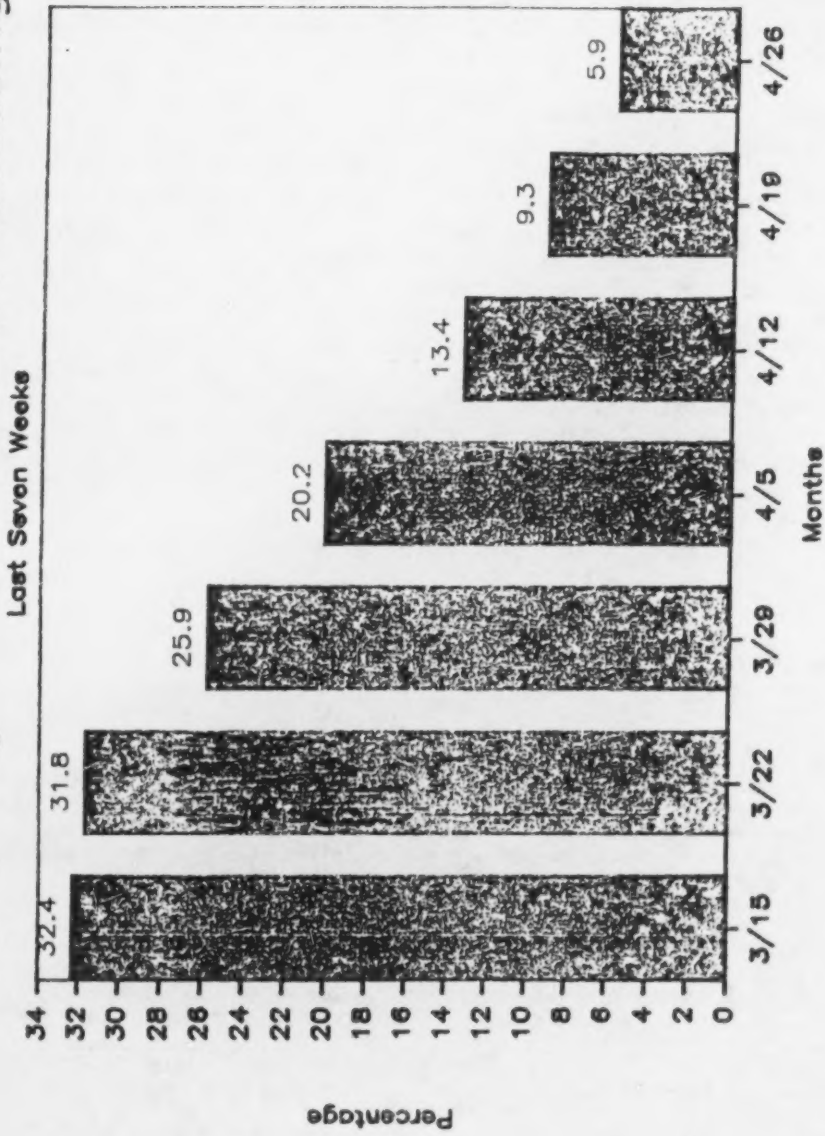
Chairman PICKLE. Then, in the main, you will be able to get all the refunds issued before the May 31 deadline?

Mr. EGGER. Yes. It is about when we certify the refund. It is about a 7- to 10-day period after we certify the refund to the Financial Management Service of Treasury before the check is actually issued.

Chairman PICKLE. Well, I recognize there may be some of the returns that you just simply cannot process. But, by and large, in the main, you think that deadline will be met and you will not be paying interest?

[The following was subsequently received:]

Percentage Behind 1984 Processing Last Seven Weeks



Mr. EGGER. I would like you to look at that chart and see where we started from on March 15. We were 32.4 percentage points behind, and as of April 26, we are down to 5.9.

Chairman PICKLE. That is good.

Mr. EGGER. And I am saying we are——

Chairman PICKLE. That is encouraging.

Well, Mr. Commissioner, we must call a recess here, and we are going to hear next the representative from the General Accounting Office with respect to the audit we have asked him to conduct of the Philadelphia office. They will be next.

Mr. Egger, will you be able to stay for that, will you or your personnel be able to stay for that audit report?

Mr. EGGER. I will have someone here who will stay.

Chairman PICKLE. I wish you would do that because we want him to be present for that.

And we will resume when we come back then with the GAO audit report.

The committee stands in recess for 10 minutes.

[Short recess.]

[The following was subsequently received:]

COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
Washington, DC, May 21, 1985.

Hon. ROSCOE L. EGGER, Jr.,
Commissioner, Internal Revenue Service,
Washington, DC.

DEAR COMMISSIONER EGGER: In follow-up to the Subcommittee on Oversight hearing on the Internal Revenue Service's FY 86 Budget and other issues that have come to my attention, I request that you respond to the series of questions listed below. Several of these questions are particularly time sensitive, therefore I would appreciate your comments and analysis on each issue as soon as possible. These questions are in addition to those requested by the Subcommittee Members and me during the hearing.

(1) *Austin Service Center.*—What exactly happened in the Austin Service Center with regard to the destruction of correspondence? What is the status of the related investigation, disciplinary action, or criminal prosecution? What other events have recently taken place in the Austin Service Center that I should be aware of? Please describe the status of, and the facts surrounding, cases alleging employee improprieties referred to the Austin Service Center's Office of Inspection (or elsewhere) in the last two years.

(2) *Detroit Payroll Center.*—Why have many personnel in the Austin Service Center had to wait weeks (or months) to receive their salary checks? To what extent has this been a problem in other Service Centers? As of today, have all employees entitled to payroll checks been paid? Are you continuing to experience difficulties in issuing payroll checks in a timely manner?

(3) *Fresno Service Center.*—Please describe the events surrounding recent allegations that 30,000 pieces of correspondence were inappropriately destroyed at the Fresno Service Center.

(4) *Refund Checks.*—It is my understanding that special telephone numbers have been set up for taxpayers who need information on the status of their refunds. How does this system work? What is the status of processing refund payments? Have taxpayers filing in January and February received their checks (12-14 weeks)? How many and what types of returns will not receive refunds by June 1, 1985? Please provide information relating to refund processing system-wide and for the Austin Service Center.

(5) *Re-Filed Returns.*—I have been informed by the staff of the Austin PRP office that the IRS has set up a new procedure (so-called re-filing policy) for taxpayers who have not received a refund after 16 weeks from the date of filing. What is this all about? Please describe in detail and submit related materials. Will these taxpayers be entitled to interest paid for untimely issuance of the refund? Where are the original returns and how many taxpayers do you estimate will be involved?

Further, I have been informed that, in the Philadelphia area, many taxpayers receiving assistance through refund inquiry numbers are first put on hold by IRS personnel and then get a recorded message telling them that there is no record of their return and that they need to refile. Is or has this been IRS practice?

In either situation, what evidence will the IRS accept as proof of filing for purposes of abating penalties or interest assessed for late filing when a taxpayer is required to refile a return after the filing deadline? Will IRS accept the same evidence of a timely filing for purposes of calculating any interest due to the taxpayer as a result of delayed processing by IRS of that refund? If the evidence to establish an attempted filing in these cases is different, how does IRS justify any variance in these standards?

(6) *Automated Collection System (ACS)*.—I understand that, under recently announced procedures, levy notices will not be generated from an ACS call site unless the taxpayer has first been contacted by telephone. Is this correct? Please send any such transmittals to the field or related materials. If this rule is in effect, what information has been gathered about the status of the affected taxpayers' accounts with regard to prior correspondence, prior calls, or instances where taxes were already paid?

(7) *Collection*.—I have been informed that the law enforcement manual will (or has) been amended to raise, from \$800 to \$1,000, the amount of tax due that the IRS will not pursue. Please discuss and explain.

(8) *Seizure Action*.—Please describe to me the events surrounding the IRS's levy and seizure of assets of Engleworld Learning Center, Inc. on November 28, 1984. I have received information prepared by the Church of Scientology alleging illegal activities by IRS agents in the seizure of the property. Please provide me with a complete accounting of this incident and submit information which explains how IRS agents are to conduct themselves in seizure actions. (If Section 6103 disclosure is necessary, please provide information under separate cover.)

I appreciate your continued cooperation.

Sincerely yours,

J.J. PICKLE,

Chairman, Subcommittee on Oversight.

[IRS responses follow (answers to questions 7 and 8 are confidential and have been retained in the committee files):]

(1) *Austin Service Center*: What exactly happened in the Austin Service Center with regard to the destruction of correspondence? What is the status of the related investigation, disciplinary action, or criminal prosecution? What other events have recently taken place in the Austin Service Center that I should be aware of?

An internal investigation at the Austin Service Center (AUSC) has disclosed that in mid-December 1984, a firstline supervisor improperly ordered the destruction of taxpayer correspondence contained in suspense inventory cases. Approximately 4000-6000 cases were handled in this manner, though there is no way to determine the exact number destroyed. In addition, due to the lack of identification of the documents involved, it cannot be determined whether the incident impacted adversely on taxpayers or caused a loss of revenue to the government.

On January 9, 1985, a Tax Examining Assistant reported to a Branch Chief that the destruction of taxpayer correspondence without the normal quality review had been ordered by the supervisor. Thereafter, the Chief of the Tax Accounts Division was informed of the allegation against the supervisor and on January 10, 1985, the allegation was reported to AUSC Assistant Director Stephen J. Stalcup and subsequently to AUSC Director, G. William Grabo.

Grabo has confirmed that he was advised of the allegations on January 10, 1985. He was informed that no numbered documents, original returns, active notices or taxpayer claims were ordered destroyed and he has received no information to date contrary to that initial report. He asked to be kept informed of the case and instructed all AUSC division chiefs to insure that all procedures were being followed and that no one was improperly disposing of inventory. After the supervisor resigned on January 15, 1985, the best determination that could be made was that this was an isolated incident and no other employees were involved. It is Mr. Grabo's belief that no documents were destroyed that could affect the accuracy of the taxpayer's accounts.

Please describe the status of, and the facts surrounding, cases alleging employee improprieties referred to the Austin Service Center's Office of Inspection (or elsewhere) in the last two years.

Concerning other employee improprieties in the Southwest Region, 16 allegations have been reported within the past two years:

Five cases have resulted in disciplinary action/resignation for disposal of taxpayer correspondence, discarding of Powers of Attorney, two incidents of lost returns and one case involving the improper destruction of three returns.

Four cases with management or Inspection investigations pending involve the theft of returns from an employee's car, missing/unprocessed documents, a microfilm tape removed by an employee and a check of some items to determine if they were inappropriately discarded. These cases have not identified the destruction of any returns.

Four cases were resolved without investigation and include three OCR tapes misplaced, but later located; a computer malfunction which resulted in a number of underreporter cases not being placed on file (being manually processed); the inadvertent loss of W-4 information due to computer error (data being reinput); and the discovery of one entity notice being found on the street.

Three cases involving allegations of lost or destroyed returns were closed without action.

(2) Detroit Payroll Center: Why have many personnel in the Austin Service Center had to wait weeks (or months) to receive their salary checks? To what extent has this been a problem in other Service Centers? As of today, have all employees entitled to payroll checks been paid? Are you continuing to experience difficulties in issuing payroll checks in a timely manner?

The payroll problems in the Austin Service Center are largely an outgrowth of the employment situation there. In order to acquire the temporary staff needed to process this year's tax returns, the Center has had to be extremely flexible in accommodating unusual tours of duty and changes in tours of duty. Further, there has been a high turnover rate. These additions, deletions, and changes in tours, particularly if they are made on short notice, are difficult to feed into the payroll system on time.

The planned implementation at Austin of several payroll system improvements that are in use elsewhere in the Service will help assure that input to the payroll system is correct. At the end of the last pay period only 15 employees of our Southwest Region, which includes the Austin Service Center, did not receive their paychecks at the scheduled time. At this time all employees entitled to a paycheck have been paid.

(3) Fresno Service Center: Please describe the events surrounding recent allegations that 30,000 pieces of correspondence were inappropriately destroyed at the Fresno Service Center.

On December 5, 1984, temporary processing procedures were instituted by management at the Fresno Service Center with the approval of the Director. These procedures concern Business Master File inquiries and were initiated to address the problems caused by the high workload volumes and backlog of cases in inventory.

The change in procedure mandated that when a taxpayer inquiry was processed and the service center's data base indicated that no money was either owed to the government or by the government, or that no such account existed, then the matter would be treated as resolved. While the cases involved were subject to normal Quality Review procedures, no contact would be made with the taxpayer. This procedure deviates from current Internal Revenue Manual guidelines.

Authorization from the National Office was not sought, nor was the Regional Office notified. Service center management considered the IRM requirement to perform master file requests to be a discretionary matter.

This change in procedure was reviewed by Western Regional officials during a review at the Fresno Service Center in January 1985, and was rescinded sometime between late January and mid-February 1985.

(4) Refund Checks: It is my understanding that special telephone numbers have been set up for taxpayers who need information on the status of their refunds. How does this system work?

The automated refund system provides responses to refund inquiries and is a supplement to our toll-free service. The equipment provides recorded tax information as well as refund information. The refund inquiry function is designed to respond to one of the most common questions asked on the toll-free system: "where is my refund?", which accounts for an estimated 4.1 million inquiries currently handled by assistants. The equipment is designed to ask the taxpayers to identify what service they want, i.e., federal tax information or refund information. Federal Tax information is available 24 hours a day, 7 days a week for tone-signalling phones, and during business hours for rotary and pulse dial phones.

Taxpayers using rotary and pulse dial phones interact with the computer through IRS employees. For example, in the tax information function, the computer asks through the employee which information topic the caller wants to hear; in the

refund inquiry function, the computer asks through the employee for necessary identification such as social security number, etc.

The equipment has been installed in 26 sites, and through the use of WATS remote call forwarding provides service to an additional 20 local calling areas. The equipment handles 25-50 incoming telephone lines, compiles all statistical information, and transmits this information via telephone data transmission to the National Office.

What is the status of processing refund payments?

As of June 21, 1985, we issued some 66.5 million refunds from timely filed 1984 Individual Income Tax Returns versus 65.8 million at the same time last year.

Have taxpayers filing in January and February received their checks (12-14 weeks)?

Although we encountered computer problems early in the filing season, most taxpayers who filed before April 15 have received their refunds, many within 10 weeks. If a taxpayer filed a return at any time before April 15 and still has not received a refund, the taxpayer should file a duplicate return.

How many and what types of returns will not receive refunds by June 1, 1985?

Until all the timely filed processable individual income tax returns are actually processed, we will not have specific data on the number of refunds delayed past June 1. Since June 1 we have processed refunds on more than 1.4 million returns.

Please provide information relating to refund processing system-wide and for the Austin Service Center.

A continued trend towards late filing by the public and a conversion to a new computer system caused service centers to start off the filing season slower than in prior years. As the filing season progressed, IRS service centers became more experienced with the new equipment and were able to process an increasing number of returns through the system. Through June 21, 1985, we have issued some 66.5 million refunds from timely filed returns versus 65.8 million refunds last year. Austin Service Center has processed 7,968,677 refunds versus 8,014,672 last year, a decrease of 45,995 refunds.

(5) Re-Filed Returns: I have been informed by the staff of the Austin PRP office that the IRS has set up a new procedure (so-called re-filing policy) for taxpayers who have not received a refund after 16 weeks from the date of filing. What is this all about?

All taxpayers who contract IRS 12 weeks after filing their original return, and have not received their refund and there is no record of their return, will be asked to file a duplicate return. A special package, including Notice 739, and "expedite" tags (copies attached) will be mailed to the taxpayers with a postage paid return envelope. All taxpayers filing duplicate returns under those procedures will have the return processed on an expedited basis, resulting in refunds within 4-6 weeks. These returns will be monitored in the service centers to ensure efficient processing.

Will these taxpayers be entitled to interest paid for untimely issuance of the refund?

Yes. Re-filed returns will be considered timely filed. Refunds paid through the expedited procedure will include interest from April 15, 1985.

Where are the original returns and how many taxpayers do you estimate will be involved?

These returns are delayed in our computer system. Processing problems that were encountered during the year resulted in returns being incorrectly processed and refunds being delayed. We have no estimate on the number of taxpayers involved.

Further, I have been informed that, in the Philadelphia area, many taxpayers receiving assistance through refund inquiry numbers are first put on hold by IRS personnel and then get a recorded message telling them that there is no record of their return and that they need to refile. Is or has this been IRS practice?

There are two methods by which taxpayers may check on their refunds. One is an automated system which will either tell the taxpayer the status of their refund or that there is no record of the return having been processed; if no record is found the taxpayer will be referred to the toll-free number. There is no message that tells the taxpayer to refile their return.

The second method a taxpayer may use is the Taxpayer Service Division toll-free number. This will provide the taxpayer with either a live answer or a written response after research is completed via the computer system. Using this method, the taxpayer may be advised to refile their return. Again, there is no recorded message telling taxpayers to refile their returns.

In either situation, what evidence will the IRS accept as proof of filing for purposes of abating penalties or interest assessed for late filing when a taxpayer is required to refile a return after the filing deadline?

Because of the special problem of the 1985 filing season and to abate any undue late filing penalties, the Service will accept as documentation, a copy of the taxpayer's check indicating that a payment was made with the original filing. Interest is based on payment of the tax. If the taxpayer has not paid the tax, whether or not the return was timely filed, interest will be assessed.

Will IRS accept the same evidence of a timely filing for purposes of calculating any interest due to the taxpayer as a result of delayed processing by IRS of that refund?

All refund returns identified by the Service as duplicates of "timely filed returns" will receive interest.

If the evidence to establish an attempted filing in these cases is different, how does IRS justify any variance in these standards?

IRS has established a special program to expedite refunds to taxpayers who have experienced delays. The majority of our processing problems occurred in the early part of the year when primarily refund returns were being processed through the system. The established policy is still appropriate in situations not connected with the unique programming problems encountered this year.

(6) Automated Collection System (ACS): I understand that, under recently announced procedures, levy notices will not be generated from an ACS call site unless the taxpayer has first been contacted by telephone. Is this correct? Please send any such transmittals to the field or related materials. If this rule is in effect, what information has been gathered about the status of the affected taxpayers' accounts with regard to prior correspondence, prior calls, or instances where taxes were already paid?

Our procedures do not require an ACS telephone call prior to sending a notice of levy in those cases where the taxpayer has been issued a Final Notice and the mail has not been returned to us undeliverable. If the taxpayer does not respond within 10 days after the Final Notice is sent, a levy may be issued five weeks later when the account comes to ACS.

Under current ACS procedures, however, the issuance of a levy on undelivered mail cases is delayed. These cases are sent to a research function to look for a new address or taxpayer telephone number. If we do not find a new address or telephone number a notice of levy may be issued if a levy source is available. Although this procedure is legally valid, we are in the process of writing new instructions to provide that, in addition, a notice of levy will not be issued in this type of case until we have attempted to contact the taxpayer at the address to which we would send the notice of levy.

No information has been gathered regarding actions on accounts previously paid. However, the Internal Revenue Manual provides that notices and enforcement action are to be suspended while taxpayer correspondence is being processed or there are unresolved issues resulting from a telephone call.

[Notice 739 (May 1985), Department of the Treasury, Internal Revenue Service]

INFORMATION SHEET—EXPEDITE REFUND PROCEDURE

Thank you for your recent inquiry concerning your 1984 Federal income tax refund. We apologize for the delay in processing your original return.

To expedite your income tax refund, we ask that you mail to us a signed copy of your tax return with copies of all Forms W-2, schedules, and attachments. The copy of your refund must have original signature(s) on page 1 (Form 1040 EZ) or on page 2 (Forms 1040 and 1040A). We will process the signed copy as your original return.

Please ensure that your social security number(s) and address are correct. Staple the enclosed "Expedite Refund" tag to the upper left hand corner of your tax return. Mail the return using the enclosed preaddressed postage-paid envelope.

Upon receipt of your tax return, we will expedite the processing of your refund check. You should receive your refund check within four to six weeks. If you do not receive your check in six weeks, please call the tax information number listed in your local telephone directory and ask for the "Problem Resolution Office."

Again, we apologize for the delay you have experienced. Questions you may have concerning this "Information Sheet" should be directed to the Tax Information number listed in your local telephone directory.

Chairman PICKLE. The subcommittee will come to order.

This committee had requested the General Accounting Office to review the difficulties being experienced at the Philadelphia Service Center and to make a report to us. We are now pleased to receive that report officially and to hear from Mr. Johnny C. Finch,

the Senior Associate Director of the General Government Division of the GAO.

So, Mr. Finch, would you proceed? We will put your entire statement in the record together with the charts that you have attached to the report. And we will be pleased to receive your report or to have you summarize or proceed as you wish.

STATEMENT OF JOHNNY C. FINCH, SENIOR ASSOCIATE DIRECTOR, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY CHRISTOPHER ABRAHAM, SENIOR EVALUATOR, AND DAVID ATTIANESE, GROUP DIRECTOR

Mr. FINCH. Thank you, Mr. Chairman.

Let me begin by introducing the colleagues at the table with me. Standing by the charts—we have a couple of charts to show you as did the Commissioner—is Chris Abraham. Chris is an audit manager in our tax group and was responsible for much of the work that we have done in terms of analyzing the IRS budget request. To my left is Dave Attianese. Dave is a group director responsible for much of the work GAO does in the area of tax administration and tax policy, and Dave was specifically responsible for managing the work that was done at Philadelphia.

With that, I will summarize very quickly the statements and then make ourselves available for questions.

We are pleased to be here today to assist your subcommittee in considering the adequacy of the administration's fiscal year 1986 budget request for IRS.

Our testimony is based primarily on our overall experience gained from conducting and reporting on audits, most of the IRS major programs and activities.

The thrust of our testimony today, Mr. Chairman, is the same as it was when we testified before this subcommittee regarding the fiscal year 1982 budget request.

We believe that administrative and legislative improvements would allow IRS to make more efficient and effective use of some of its existing resources. Nevertheless, we also believe that IRS needs additional resources to more effectively administer our Nation's tax system.

The IRS workload continues to grow because of several factors. These include the decline in voluntary compliance with the tax laws, the rise in special compliance problems, the increase in the scope and complexity of the laws IRS is charged with administering, the increase in the number of returns filed, and the increase in the number of requests for assistance from taxpayers. However, IRS resources have not kept pace with these trends. In fact, the budget that the administration proposes for fiscal year 1986 plans to cut the IRS staff by 1.4 percent and funding by \$30 million.

The Federal Government's financial well-being depends in large measure on whether people are willing and able to support our Nation's tax system. As shown on chart 1 before you, and in attachment 1 to my detailed statement, our tax system provides about 90 percent of the revenues for financing the Government's programs and activities.

In 1984, the system provided about \$667 billion in revenue from all sources and the IRS budget was \$3.3 billion.

Despite the importance of our Nation's tax system, it is facing severe strains. For example, IRS estimates that in 1976 the legal source tax gap was \$39 billion, and in 1981 it was \$81.5 billion. IRS projects that compliance will continue to fall despite increased recent congressional efforts to address the problem.

Chart 2 before you and attachment 2 to my detailed statement show the expected decline in taxpayer compliance through 1990. IRS estimates that by then the legal source tax gap will reach \$166 billion, double the 1981 level. This is very significant in view of the huge deficits the Federal Government incurs to meet its obligations. As chart 2 also shows, based on IRS projections, taxes owed but not paid from legal source income are equal to a significant portion of the Federal budget deficit. For example, had taxpayers fully complied in 1981, the last year for which detailed estimates are available, the Government would have had a surplus of \$2.5 billion instead of a deficit of \$79 billion.

Along with the general decline in voluntary compliance, several special compliance problems and issues have emerged in recent years which further jeopardize the tax system. These problems, which include abusive tax shelters, use of overseas tax havens, and illegal tax protestors, require special handling. The resources devoted to these problems are being diverted from regular functions, thus reducing IRS ability to maintain a significant overall presence.

The scope and complexity of the Tax Code has also added to the IRS burden. New and changed tax laws create work throughout IRS for which adequate additional resources have not always been provided. For example, IRS estimated that administering the Deficit Reduction Act of 1984 would require 1,060 staff years in 1985 and 1,624 in 1986. However, OMB allowed no additional staff for 1985 and only 290 additional positions for 1986.

In addition to the problems created by noncompliance and the complexity of the tax laws, IRS must cope with an increasing workload created by the annual growth in the taxpaying population as evidenced by the increasing number of tax returns filed, a 46-percent increase from 1976 to 1986. However, IRS resources have not kept pace with the growth in this workload. In fact, if the current request is approved by the Congress, total IRS resources will have dropped 1.3 percent between 1984 and 1986.

IRS efforts to modernize its computer systems will produce some productivity gains. However, these new systems will not replace the need to audit face to face, put liens on property, investigate cases, or process documents.

Having illustrated the increasing demands being placed on IRS resources, I would now like to highlight the fiscal year 1986 request for certain IRS programs and activities.

Although the administration is requesting an increase in the average positions for IRS examination activities, IRS data shows that its examination resources have not kept pace with the increase in tax return filings. In this regard, while filings will increase 46 percent from 1976 to 1986, the examination staff will have increased by less than 5 percent. This increase, combined with the increasing

complexity of the returns filed will reduce examination coverage from 2.6 percent in 1976 to an expected 1.2 percent in 1986.

Regarding collections activities, IRS collection resources have not kept pace with growing delinquent account and delinquent return inventories. According to IRS, tax revenue and active taxpayer delinquent accounts at the end of 1986 will be \$7.6 billion, down from \$8.5 billion at the end of 1984. However, we believe these figures understate the total collection problem because they refer only to the yearend inventories of active taxpayer delinquent accounts. On this basis, although IRS reported \$8.5 billion in delinquent accounts at the end of fiscal year 1984, the actual amount of total accounts receivable outstanding was \$30.1 billion.

In addition to the \$8.5 billion, the \$30.1 billion included: \$8.8 billion in accounts which were in the notice process, \$6.3 billion in accounts classified as currently not collectible, \$0.9 billion in installments and deferred accounts, and \$5.6 billion in other accounts.

Using this broad measure, chart 3 before you and attachment 5 to my detailed statement shows that for the last 5 years, total accounts receivable have been growing at a faster rate than net revenues collected by IRS. Even in 1983 when tax liabilities decreased as a result of tax cuts, accounts receivable grew by 5 percent.

In spite of the revenue potential and the large delinquency inventories, IRS is continuing to reduce its collection staff. In this regard, the IRS fiscal year 1986 request calls for reducing collections resources by 801 average positions.

The fiscal year 1986 budget proposal also calls for a reduction of 156 staff years for taxpayer assistance activities.

We are concerned that even current taxpayer assistance levels may be inadequate to meet taxpayer needs. In a recent survey, we found, for example, that taxpayers could expect to contact an IRS telephone assister and get a tax law question correctly answered in five or fewer calls only 52 percent of the time. The main reason for the low success rate was the inability to get through within five calls.

Given the increasing inquiries being generated by the various tax law changes, increasing taxpayer population and other factors, the planned reduction in taxpayer assistance may further reduce a taxpayer's chance of getting a tax question successfully answered.

Our work has shown that IRS can improve the management of its compliance programs and other activities to permit more efficient use of existing resources. Even so, the magnitude of the compliance problem and the increase in both the number and complexity of return filings pose demands for IRS so great that program efficiencies, including optimal resource allocations among programs, will go only so far in protecting the tax system.

In our view, an increase in IRS resources is warranted. However, due to shortcomings in IRS management information, we cannot state precisely to which programs additional resources should be allocated to optimize use of all available resources.

In closing, let me set forth some considerations that we believe the Congress should keep in mind when deliberating on the desirability of providing IRS more resources.

First, the Congress should be mindful of the IRS unique revenue collection role. IRS collects the majority of the revenues used to finance Federal Government programs and activities and produces about \$100 in tax revenues for every 50 cents it spends. Therefore, Government-wide reductions applied to IRS could result in reducing the revenues available to fund other Government programs and deal with the growing Federal deficit.

Second, it is important to keep in mind that the IRS various compliance activities do no more than require citizens to pay those taxes that were properly due in the first place and that, in fact, were so paid by most of them. Effective compliance should not be viewed as representing a special burden on the public. Rather, it is aimed at ensuring that all pay their fair share.

Finally, with respect to the question at hand, namely how many additional resources should IRS be provided with, let me offer the following:

There is no doubt that IRS can return in added revenue some multiple of the additional funds it is provided. The problem, however, is trying to identify the optimum allocation application of any finite amount of such resources. It is important that any additional resources provided to IRS not be more than IRS can effectively recruit, train and assimilate. Given the lack of available data for making optimum allocations, the best approach might be to ask IRS for its informed judgment on how various incremental funding increases would be applied.

That concludes my prepared statement, Mr. Chairman. I would be pleased to answer your questions.

[The prepared statement follows:]

STATEMENT OF JOHNNY C. FINCH, SENIOR ASSOCIATE DIRECTOR, GENERAL
GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and members of the subcommittee, we are pleased to be here today to assist your Subcommittee in considering the adequacy of the administration's budget request for IRS for fiscal year 1986. Our testimony is based primarily on our overall experience gained from conducting audits of tax administration operations and activities. Over the past several years, we have reviewed and reported on most of IRS's major programs and activities.

The thrust of our testimony today, Mr. Chairman, is the same as it was when we testified before this Subcommittee regarding the fiscal 1982 budget request—that while administrative and legislative improvements would allow IRS to make more efficient and effective use of its existing resources, IRS needs additional resources to more effectively administer our nation's tax system.

IRS' workload continues to grow because of (1) the decline of voluntary compliance with the tax laws, (2) the rise in special compliance problems, (3) the increase in the scope and complexity of the laws IRS is charged with administering, (4) the increase in the number of returns filed, and (5) the increase in the number of requests for assistance from taxpayers. IRS' resources have not kept pace with these trends. In fact, the budget that the administration proposes for fiscal year 1986, in the face of these needs, plans to cut IRS' staff by 1.4 percent and funding by \$30 million. In addition, the request proposes to fund a portion of the January 1985 civilian pay raise by eliminating 802 positions which Congress has authorized for fiscal 1985.

IMPORTANCE OF TAX SYSTEM

The federal government's financial well-being depends, in large measure, on whether people are willing and able to support our nation's tax system. As shown in attachment I to my statement, our tax system provides about 90 percent of the revenues for financing the government's programs and activities. In 1984, the system provided about \$667 billion in revenue from all sources, and IRS' budget was \$3.3

billion. Thus, administering the tax system cost about 50 cents for each \$100 of tax paid.

To assure that the tax system provides maximum revenue at least cost, IRS must strive to obtain the highest possible degree of voluntary compliance with the tax laws. However, growing numbers of people in this country are not complying voluntarily, and even a slight decrease in compliance levels translates into billions of dollars of foregone tax revenue annually. This is very significant in view of the huge deficits the federal government incurs to meet its obligations. As attachment II shows, based on IRS projections, taxes owed but not paid from legal source income are equal to a significant portion of the federal budget deficit. For example, had taxpayers fully complied in 1981—the last year for which detailed estimates are available—the government would have had a surplus of \$2.5 billion instead of a deficit of \$79 billion.

TAXPAYER COMPLIANCE CONTINUES TO DECLINE

Despite the importance of our nation's tax system, it is facing severe strains. There is a trend toward contempt and abuse of the system which seriously undermines the basic concept of voluntary compliance on which the system is based. Extensive evidence is available to show that noncompliance among both corporate and individual taxpayers is a serious problem.

IRS and others have conducted detailed surveys attempting to determine why people do not comply and the extent to which they fail to comply. For example, in a December 1984 study conducted for IRS by Yankelovich, Skelly and White, Inc. almost twenty percent of the sampled population admitted to cheating on their federal income taxes. The study found that the personal definitions of honesty and the belief that most people are noncompliant were the most significant reasons people did not comply.

That survey helps to validate IRS' July 1983 report on income tax compliance research. In this study the IRS developed estimates of the extent, composition, and growth of taxpayer noncompliance. It shows that for tax year 1981 individual and corporate taxpayers did not pay taxes totaling \$81.5 billion on income from legal sources, a noncompliance rate of 19.3 percent. Attachment III shows that for 1981, the \$81.5 billion income tax gap consisted of:

- Tax on individual filers' unreported income (\$52.2);
- Tax on overstated individual personal deductions (\$6.6 billion);
- Tax on overstated business expenses (\$6.3 billion);
- Tax reported on the return but not fully paid (\$4.4 billion);
- Corporation tax gap (\$6.2 billion);
- Nonfilers net tax liability (\$2.9 billion);
- Withheld tax not paid by employers (\$2.4 billion); and
- Net math errors (\$.5 billion).

IRS's July 1983 report shows that not only is overall noncompliance a serious problem, but it has grown worse. IRS estimates that in 1976 the tax gap was about \$39 billion. IRS has projected that compliance will continue to fall despite increased recent congressional efforts to address the problem. Attachment II shows the expected decline in taxpayer compliance through 1990. By then, IRS estimates that the legal source tax gap will reach \$166 billion—double the 1981 level.

SPECIAL COMPLIANCE PROBLEMS CONTINUE TO CAUSE ADMINISTRATIVE DIFFICULTY

Along with the general decline in voluntary compliance among both individual and corporate taxpayers, several special compliance problems and issues have emerged in recent years which further jeopardize the tax system. These special problems require special handling. The resources devoted to these problem areas are being diverted from normal functions, thus reducing IRS' ability to maintain a significant overall presence. These special problems include: (1) abusive tax shelters; (2) use of overseas tax havens; and (3) illegal tax protesters. While each of these problems is complex enough to merit its own study, I would like to briefly highlight them and discuss their impact on the fiscal 1986 budget request.

One of the major compliance problems, both in terms of revenue involved and resources required, is the widespread use of abusive tax shelters. While tax shelters generally are transactions used by taxpayers to reduce their otherwise taxable income, abusive tax shelters have tax benefits not economic benefits, as their primary consideration. IRS defines abusive tax shelters as those shelters which utilize extreme, improper, or even illegal interpretations of the law or the facts to obtain tax benefits clearly disproportionate to the economic reality of the transactions.

IRS is using staff from at least 5 different IRS functions—Examination, Criminal Investigation, Returns Processing, Appeals, and Tax Litigation—to deal with the abusive shelter cases. Examination spent about 10 percent of its resources in fiscal 1984 on abusive shelters. As of December 1984, over 370,000 returns with tax shelter issues were in the examination process—more than twice the FY 1980 inventory of about 174,000.

About 24,000 of the 62,000 pending Tax Court cases involve tax shelter issues. IRS estimated for 1981 that the Treasury had an annual revenue loss of about \$3.6 billion attributable to abusive tax shelters.

Noncompliance relating to international taxation issues particularly tax havens, is another difficult and growing problem. In our April 1983 testimony before the House Subcommittee on Commerce, Consumer, and Monetary Affairs of the Committee on Government Operations, we stated that tax havens are a problem with no easy solution. The banking and commercial secrecy laws of tax haven countries limit IRS' access to information needed to assure compliance with U.S. tax laws. Further, imposition of a low or zero tax rate on all or certain categories of income combined with no currency controls on non-residents creates a strong incentive for U.S. individuals and businesses to establish shell corporations in tax havens in order to evade U.S. taxes.

IRS' efforts to detect and deter tax haven abuses are limited in most cases by the lack of available information. The normal types of taxpayer information such as wage and investment income statements (W-2's and 1099's), cancelled checks, and bank statements, are not generally available. Thus, IRS must rely on other means to identify taxpayers who are evading taxes through the use of tax havens.

In this regard, IRS's Criminal Investigation Division has become involved in efforts to detect those who are illegally using tax havens. However, as we mentioned previously, the lack of available information makes such schemes difficult to uncover. As a result, such investigations are very labor intensive and costly. In 1984, about 7 to 10 percent of the Criminal Investigation Division's ongoing cases directly involved tax havens or money laundering activities. But, according to IRS officials, tax havens issues are so broad that estimates of total involvement are difficult to develop.

One special compliance problem with which IRS appears to have made progress since our last testimony before this Subcommittee is that of illegal tax protesters. IRS has taken action to address the tax protester problem through more effective use of its resources. From 1980 through 1983, illegal tax protester returns, such as those returns citing the Fifth Amendment to the Constitution as a justification for not completing the return, increased from 19,482 to 58,040—an increase of 38,558 or 198 percent. In 1984, the number of these protester returns decreased to 53,760 or 7.4 percent from 1983.

IRS officials believe this decrease can be directly attributed to their enforcement efforts which have targeted both the leaders and promoters of major protest groups and schemes with significant numbers of participants. For example, approximately 1,000 individuals who purchased mail order ministries and illegally reported as contributions deductions they made to their own churches will be required to pay millions of dollars in back taxes and penalties. These cases usually involve a "church" in the person's residence and the person's family is the "congregation." The person then deducts from income contributions made to pay personal living expenses.

In addition to civil actions, IRS has also had a high success rate in obtaining criminal convictions against tax protesters. From fiscal 1982 to 1984, IRS obtained indictments against 585 protesters. During the same period, 515 protesters were convicted and 412 prison terms were imposed. IRS officials commented that the high percentage of those indicted who are convicted and the high percentage of those convicted who receive prison sentences has significantly reduced the number of persons willing to file protester returns.

IRS has attacked the protester problem with staff from several functions. Criminal Investigation began 648 illegal tax protester investigations in 1984, an increase of over 50 percent since 1981. However, solving the tax protester problem will not necessarily decrease IRS compliance problems. IRS officials believe that many protesters are switching to other less obvious tax evasion schemes. For example, rather than filing a protest return, some protesters are now using abusive tax shelters and foreign tax havens to reduce their taxes. Thus, tax protest activity may add to problems which are already straining IRS resources.

SCOPE AND COMPLEXITY OF THE TAX LAW CONTINUES TO INCREASE

Interrelated with the noncompliance problem is the scope and complexity of the tax laws which has added to IRS' administrative burden. The complexity of the tax laws often makes IRS' audits of tax returns more difficult and produces numerous controversies between IRS and taxpayers. In addition, both IRS and taxpayers must spend considerable effort in adjusting to the continuing changes in the law.

New tax laws create new work throughout IRS for which adequate additional resources may not be provided. For example, IRS estimated that administering the Deficit Reduction Act of 1984 would require 1,060 staff years in 1985 and 1,624 in 1986. However, OMB allowed only 290 additional positions in examination for 1986 and no additional staff for 1985. As a result, if IRS is to effectively administer the new law, it will have to divert staff from other work.

The increasing complexity of and frequent changes to the law are also impacting other areas. For example, two major legislative efforts—the Tax Equity and Fiscal Responsibility Act [TEFRA] and the Deficit Reduction Act of 1984—while providing some simplification, have also created new complexities. TEFRA added, amended, or repealed 245 separate sections of the Internal Revenue Code. Changes to the law, such as these, in many instances required changes to the information which IRS provides to explain the law to taxpayers and their representatives. For example, these two acts have resulted in over 250 regulations projects. In 1984, IRS and the Treasury only closed 105 projects total. Given this rate of closure, the regulations arising from these two measures alone will require over two years of the IRS's total regulations production.

The increasing impact of complexity can be seen in several other areas. Despite efforts to create a separate simple tax form, the 1040EZ, and to make the 1040A useable by additional taxpayers by allowing a schedule to be attached to the form, more taxpayers are filing the longer form 1040 each year. Form 1040 now makes up 63 percent of the individual returns filed—an increase from 61 percent in 1982.

These more complex returns being filed add to the difficulty in determining the correct tax when a taxpayer is audited. Examination time has increased by 11 percent from 1981 to 1984. IRS believes that part of the increase can be attributed to the increasing complexity of the returns being examined.

In addition, more taxpayers whose returns are audited are disputing the changes recommended by IRS examiners. IRS projects that taxpayers will appeal about 70,000 cases in 1986. In addition, the Tax Court expects to receive 65,600 new cases in 1986, a 50 percent increase over 1984.

THE NUMBER OF RETURNS FILED HAS INCREASED

As the federal agency responsible for administering the nation's tax system, IRS must cope with an increasing workload created by the year-to-year growth in the taxpaying population as evidenced by the increasing number of tax returns filed. To cope with this workload, IRS has one of the largest workforces of all federal nondefense agencies. However, IRS' resources have not kept pace with the growth in its workload.

For example, IRS expects 179 million tax returns to be filed in 1986—a 46 percent increase since 1976 when 123 million were filed. Of these returns, individual return filings will increase 25 percent from 83 million in 1976 to 104 million in 1986. While improvements in productivity—including increased use of computer technology—mean that increases in return filings do not necessarily require proportionate increase in IRS resources, it is still noteworthy that, between 1976 and 1986, IRS' resources will have increased by less than 3 percent. IRS has only grown from 84,300 to 86,500 staff years. If the current request is approved by the Congress, total IRS resources will have dropped 1.3 percent between 1984 and 1986. IRS' latest effort to modernize its computer systems will produce some productivity gains. However, these new systems will not replace the need to audit face to face, put liens on houses, investigate cases, or process documents.

INCREASES IN NEED FOR TAXPAYER ASSISTANCE

To meet their responsibility to pay their taxes, taxpayers must be able to understand tax law requirements. However, taxpayers historically have had difficulty understanding IRS forms and publications. For example, in our 1978 report on *Further Simplification of Income Tax Forms and Instructions Is Needed and Possible* (GGD-78-74, July 5, 1978), we concluded that Form 1040 packages were written at a reading level beyond the comprehension of many taxpayers. As a result, IRS initiated actions to make forms and instructions easier to read and understand. By fiscal year

1983, IRS had simplified the 1040A, and introduced the 1040EZ, which was half as many lines as the 1040A. However, there are indications that IRS' efforts have not completely alleviated the problem.

Our report on the *Need to Better Assess Consequences Before Reducing Taxpayer Assistance* (GGD-84-13, April 15, 1984) indicated that a substantial number of taxpayers were still having difficulty understanding IRS' written materials. The questionnaire we sent to taxpayers during our 1982 study contained a question relating to the clarity of IRS tax forms, instructions, and publications. And, the responses we received indicated that, even after IRS' simplification efforts, a significant percentage of taxpayers continued to have difficulty in understanding IRS' written documents. For example, 41 percent of all taxpayers said they had difficulty understanding tax forms and instructions and 22 percent had difficulty understanding IRS publications.

Because the Internal Revenue Code has evolved into an extremely complicated array of exemptions, exclusions, deductions, and credits, taxpayers often need assistance in meeting their obligations. In addition to the publications IRS also answers tax law questions over the telephone, at walk-in offices and through correspondence. According to IRS statistics, during fiscal year 1984, taxpayers called IRS 42.2 million times—and increase of 22 percent since 1980. Total taxpayer assistance activity also increased 14 percent from 43 million contacts to 50.1 million in 1984.

IRS RESOURCES HAVE NOT KEPT PACE WITH GROWING WORKLOAD DEMANDS

Attachment IV shows the staff resources and workload trends for major IRS components for selected fiscal year 1976, 1984, and 1986. To illustrate the increasing demands being placed on IRS resources, I would like to discuss the fiscal year 1986 request for several specific IRS programs and activities.

Examination activities

The largest single program that the IRS has is its examination effort, for which the administration is requesting 29,518 average positions for 1986—an increase of 1,468 since 1984. IRS data shows that IRS' examination resources have failed to keep pace with the increase in tax return filings. As mentioned earlier, filings will increase 46 percent from 1976 to 1986. However, for the same period examination staff will have increased by less than 5 percent. Thus the 46 percent increase in filings, combined with the increasing complexity of the returns filed, will reduce examination coverage from 2.6 percent in 1976 to an expected 1.2 percent in 1986. As recently as 1980, IRS examined more than 2 percent of returns filed.

In addition to the positive impact examining returns has on overall compliance, devoting resources to the examination of returns has direct benefit to the revenue position of the government. For example, IRS actually assessed \$10.2 billion in additional taxes, penalties, and interest in 1984. Furthermore, IRS projects that the examinations which will be conducted in 1986 will eventually lead to assessments of \$14.4 billion.

Perhaps the best way to illustrate the benefit of increasing examination resources is to use an historical example. In a 1981 hearing before this Subcommittee, we suggested that IRS resources should be increased. Due in great part to this Subcommittee's efforts and support, a total of 5,000 additional staff were added to IRS' fiscal 1982, 1983 and 1984 budgets of which 1,000 were assigned to the examination function. IRS' examination model shows that the 1,000 staff added to the program recommended adjustments which will lead to about \$1 billion through additional examinations they made in fiscal year 1984.

The Grace Commission also suggested that additional resources could assist in raising revenue. Its report estimated that increasing the examination of returns could generate a net revenue gain of \$2.7 billion over 3 years. The commission proposed that 7,500 additional positions be added to examination at a rate of 2,500 per year. The administration has endorsed this recommendation and has proposed to implement it beginning in 1987. Using more current yield and cost data, IRS estimates that this initiative would generate \$4.6 billion additional tax revenue between 1987 and 1989 at a cost of about \$600 million.

Collections activities

As with the examination function, IRS' collections resources have also not kept pace with growing delinquent account and delinquent return inventories. IRS is proposing in its fiscal 1986 request to cut resources devoted to collection by 801 average positions.

According to IRS, tax revenue in active taxpayer delinquent accounts at the end of 1986 will be more than four times the 1976 level—increasing from \$1.7 billion

involving 614,000 accounts to \$7.6 billion involving 1.7 million accounts. However, these figures understate the total collection problem because they refer only to the year-end inventories of active taxpayer delinquent accounts. On this basis, IRS reported \$8.5 billion in delinquent accounts at the end of fiscal year 1984—but the actual amount of total accounts receivable outstanding was \$30.1 billion. In addition to the \$8.5 billion, the \$30.1 billion included:

- Accounts which were in the notice process (\$8.8 billion);
- Accounts classified as currently not collectible (\$6.3 billion);
- Installments and deferred accounts (\$0.9 billion); and
- Other (\$5.6 billion).

Using the broad measure of total accounts receivable shows that collection of taxes owed may be an increasing problem. Attachment V shows that for the last five years total accounts receivable have been growing at a faster rate than net revenues collected by IRS. Even in 1983, when tax liabilities decreased as a result of tax cuts, accounts receivable grew by 5 percent. Not only have accounts receivable been growing relative to total collections, but, as shown in attachment VI, they have also been growing in absolute terms.

How much revenue is collected by the collections function relates to the size of the staff available to work the cases. To use the historical example I referred to previously, the other 4,000 staff added in the revenue initiative were assigned to the collections function. IRS reports that this added staff from fiscal years 1983 to 1985 collected \$4.7 billion from delinquent accounts and \$1.6 billion from securing additional delinquent returns from nonfilers. In spite of the revenue potential and the large delinquency inventories, IRS is continuing to reduce its collection staff.

While IRS has made significant progress in automating its collections operation, IRS has not been able to reduce its overall collections workload. In the fiscal 1986 budget request, most of the 802 positions to be eliminated are clerical staff. Because IRS is pursuing a number of automation initiatives to improve control over cases and reduce paperwork, it is likely that IRS will be able to successfully absorb these reductions. However, the administration has not correspondingly increased the number of revenue officers. In fact, the current budget calls for a reduction of 19 revenue officer positions. However, work assigned to revenue officers in the field has increased since March 1983. At the end of March 1985, revenue officers were handling 1.1 million accounts worth \$7.4 billion and 324,000 delinquent returns investigations. Compared to the same period in 1983, the number of delinquent accounts has increased by 15 percent while the dollar amount of these cases has increased 27 percent. Similarly, the number of delinquent returns investigations has increased by approximately 32,000.

Returns processing activities

Another area where resources are being reduced in the face of growing workload is in processing tax returns at the service centers. Since 1982, the number of staff in returns processing has dropped 5 percent from 24,015 to 22,846. From 1982 to 1986 IRS has estimated productivity savings in Returns Processing of 5,210 staff years, an average of 1,042 a year. This has more than offset the 3,379 total staff years required from 1982 to 1986 for workload increases. In the 1986 request, however, the administration proposes to reduce staff by an additional 425 positions by using selective verification of tax data and by modifying procedures used to process tax returns.

Criminal investigation activities

Another area absorbing cutbacks while resource needs are growing is criminal investigation. IRS has planned to reduce its criminal investigation efforts in fiscal 1986 by 74 average positions (1.5 percent) primarily by reducing administrative support. IRS is also continuing its commitments to task forces on organized crime and drug enforcement. In fiscal 1986 IRS estimates that this effort will require 262 average positions in this program (about 5.9 percent of the staff). IRS expects that, as a result of the lower staffing levels and increasing outside commitments, it will only be able to undertake about 6,150 investigations in 1986, down from about 6,200 in 1984.

Taxpayer assistance activities

IRS also plans to make further reductions in its Taxpayer Assistance activities. The fiscal 1986 budget proposal for IRS requests a reduction of 156 staff years for taxpayer assistance.

To absorb the currently planned cutbacks in Taxpayer Assistance for 1986, IRS plans to increase the use of volunteers and hold the tele-tax system at current levels. As we discussed earlier, our April 1984 report questions whether there are

ready substitutes for the person-to-person telephone assistance that IRS now provides to help taxpayers answer tax law questions. Alternatives such as volunteers and commercial assisters may not fill the gap.

We are also concerned that current levels of IRS's Taxpayer Assistance may be inadequate to meet the needs. In a recent survey we found, for example, that taxpayers could expect to reach a telephone assister on the first call 31 percent of the time in a two week period during the 1985 filing season. We also determined that taxpayers could expect to contact an IRS telephone assister and get a tax law question correctly answered in five or fewer calls 52 percent of the time. The main reason for the low success rate was the inability to get through within 5 calls. When we did reach them, IRS staff correctly answered the questions 86 percent of the time.

Given the increasing inquiries being generated by the various tax law changes, increasing taxpayer population, and other factors, the planned reduction in taxpayer assistance may further reduce a taxpayer's chance of getting a tax question successfully answered.

ADMINISTRATIVE AND LEGISLATIVE IMPROVEMENTS COULD HELP, BUT ADDITIONAL RESOURCES ARE ALSO NEEDED

Various administrative and legislative actions would permit IRS to make more efficient and effective use of its existing resources. However, such actions alone would not be sufficient to counter the growth in workload brought on by decreasing compliance, the increasing scope and complexity of the tax laws, and the increasing number of returns filed. Therefore, additional resources are needed if IRS is to maintain the integrity of the tax system and achieve maximum collection of federal revenues.

Available resources can be used more efficiently

Our work has shown that IRS can improve the management of its compliance programs and other activities to permit more efficient use of existing resources. As we testified in 1982, IRS was at a serious disadvantage in deciding how to best structure its compliance activities to encourage people to comply with the tax laws. IRS lacked sufficient data to understand how its compliance programs, individually and collectively, affect compliance. Since that time IRS has undertaken a number of research efforts to help it to better understand taxpayer noncompliance and the impact of its programs on the problem. IRS research in this area is continuing.

In the short run, IRS may want to reduce tax losses by giving greater emphasis to maximizing revenue in allocating resources among and within its compliance programs. To do that, IRS needs accurate data on the cost and revenue yield of its compliance programs. Generally, it has data showing only "average" dollar yields. IRS' management information systems do allow measurements of yield "at the margin" for the examination program, but they do not provide marginal yield data for other compliance programs.

Although IRS' cost/yield data must be used with caution, we believe that small increases in resources in various programs would provide average revenue yields that significantly exceed average cost. This is particularly true for accounts receivable, where additional resources would have a sizable immediate impact on revenue collections. Unfortunately, however, the shortfall in IRS' management information is such that no one knows where diminishing returns will make further resource investment uneconomic at the margin.

IRS plans to implement a new, more comprehensive management information system as part of its current efforts to modernize its computer systems. This system, which is now in operation in some areas and is scheduled to be operational nationwide in January 1986, will supply much of the data needed to make these allocation decisions and to better support IRS resource requests. However, IRS believes that, given current resource constraints, nationwide operation of the comprehensive system may be delayed.

One segment of the comprehensive information system is now available to help the IRS determine what is the effect of various levels of resources. Already, IRS is able to use average yield data from its various compliance programs to model the effect of adding small numbers of staff to various programs. This enables IRS to develop projections of potential revenue yield from increasing resources available to the various compliance programs. IRS can also estimate costs of adding staff, including staff in other functions such as Returns Processing. IRS used this system to model the effects of the proposed 7,500 staff year revenue initiative and to develop yield and cost data.

This management information system is just one example of how administrative changes can improve IRS efficiency. In the course of our work we have identified a number of other changes which IRS can make to improve its operations. In addition to these administrative changes, legislative actions can also help in addressing significant problems. Let me just cite briefly one example where we are finding significant improvement in taxpayer compliance as a result of Congressional action.

One of the most serious compliance problems is the continuing growth of unreported legal source income. According to IRS' most recent estimates, the tax gap stemming from this area has risen dramatically since 1973. According to IRS, in 1981, \$249 billion of legal source income for individuals was not reported. IRS estimates that as a result of this underreporting of legal source income over \$52 billion of federal income taxes was not paid.

Congress has taken steps to deal with broad segments of this area. It has given IRS new tools to better detect unreported income. Now much of this unreported income is subject to an effective compliance tool—information reporting. Generally, only those areas subject to withholding have higher compliance rates than those subject to information reporting.

One compliance problem area now subject to this requirement is restaurant tips. IRS estimates that for 1981, taxpayers failed to report and pay taxes on over \$8.5 billion of tip income—a compliance rate of less than 20 percent. This income accounted for about 41 percent of the \$18.9 billion total wage reporting gap for filers in 1981. The Congress addressed the tip income noncompliance problem in TEFRA. The act imposes additional reporting requirements on the owners of certain food and beverage establishments. IRS estimates that voluntary reporting of tip income has doubled as a result of these changes.

However, some income is not covered by information reporting. Information reporting is difficult to use a method for increasing voluntary compliance from sole proprietorships, partnerships, and small business corporations. Another example is the unreported income involving cash related to informal arrangements—the core of the underground economy. These payments are not subject to information reporting. Yet, IRS found that taxpayers only report 20.7 percent of this income voluntarily. Accordingly, these areas represent compliance problems that may require other solutions.

During our work at IRS, we have identified a number of other areas where legislative changes are needed. Attachment VII to my statement lists open legislative and administrative recommendations which we have made which would contribute to improved compliance and/or IRS efficiency.

More resources are needed

Even though IRS can use its resources more efficiently and effectively, the magnitude of the compliance problem and the increase in both the number and complexity of return filings pose demands for IRS so great that program efficiencies, including optimal resource allocations among programs, will go only so far in protecting the tax system. In our view, an increase in IRS' resources is warranted. Such an increase, within reason, would not increase the federal budget deficit. This is because IRS' compliance programs, on the average, generate tax revenue in amounts that far exceed the programs' cost. For example, in 1984 the average-yield-to-cost ratio was 10.4 for examination of returns and 19.4 for taxpayer delinquent accounts, according to data compiled by IRS. Additional information on program yield for each dollar spent is given in attachment VIII.

While we know that the problems with the nation's tax system require attention, we cannot state precisely to which programs additional resources should be allocated to optimize use of all available resources. We do know, however, that additional resources in some programs will result in a large and immediate flow of tax revenue to the Treasury. These resources are not only justified by the potential revenue gains, but, of equal or more importance, by the need to cope with IRS' increasing workload due to decreasing voluntary compliance, increasing tax law complexity, and increasing taxpaying population.

There are fundamental questions of fairness and of taxpayers' perception which, we think, should also be kept in mind when considering IRS' budget request. Is it fair that the vast majority of taxpayers pay their proper share, while

- the returns of many taxpayers with high potential for tax change go unaudited,
- tax evasion goes uninvestigated, and
- unpaid taxes are written off?

Taxpayers' perceptions that others can get away with not complying with the tax laws jeopardizes the entire system.

In closing, let me set forth some considerations that the Congress should keep in mind in deliberating on the desirability of providing IRS with more resources.

First, the Congress should be mindful of IRS' unique revenue collection role. IRS collects the majority of the revenues used to finance federal government programs and activities and produces about \$100 in tax revenues for every 50 cents it spends. Therefore, government-wide reductions applied to IRS could result in reducing the revenues available to fund other government programs.

Second, it is important to keep in mind that IRS' various compliance activities do no more than require citizens to pay those taxes that were properly due in the first place, and that in fact were so paid by most of them. Effective compliance should not be viewed as representing a special burden on the public; rather it is aimed at ensuring that all pay their fair share.

Finally, with respect to the question at hand, namely how many additional resources should IRS be provided with, let me offer the following. There is no doubt that IRS can return in added revenue some multiple of the additional funds it is provided. The problem, however, is trying to identify the optimum application of any finite amount of such resources. It is important that any additional resources provided to IRS not be more than IRS can effectively recruit, train, and assimilate. Given the lack of available data for making optimum allocations, the best approach might be to ask IRS for its informed judgment on how various incremental funding increases would be applied. For example, as before, Congress could task IRS with calculating the operational, revenue, and cost impacts of personnel gains of some staff-year increment, 500 for example, ranging up to perhaps a total increase of 5,000 people.

The Subcommittee could also consider asking IRS what would be the effect if, with regard to this fiscal 1986 budget request, the Congress were to:

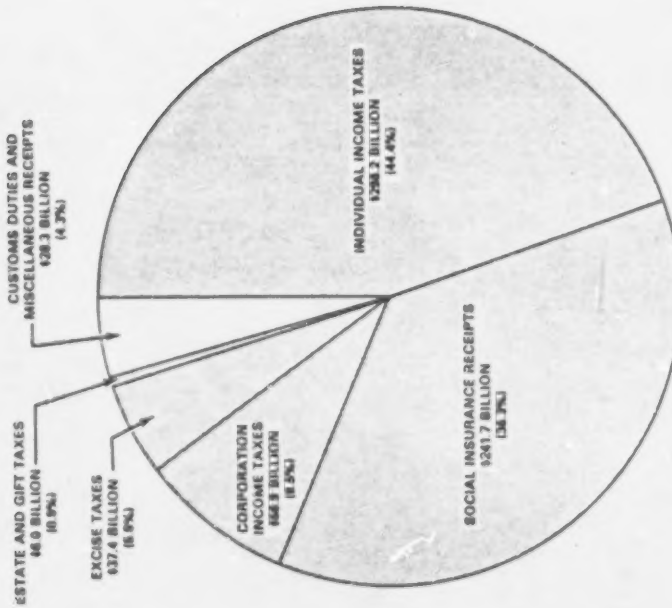
- Eliminate proposed cuts in collection, criminal investigation, and taxpayer service.
- Provide supplemental funds for the January 1985 pay raise instead of funding most of the raise through an 802 staff year reduction.
- Begin the three year, 7,500 staff year increase for examination in fiscal 1986 instead of fiscal 1987.

That concludes my prepared statement. I would be pleased to answer any questions.

ATTACHMENT I

ATTACHMENT I

FEDERAL REVENUES
FISCAL YEAR 1984 ACTUAL

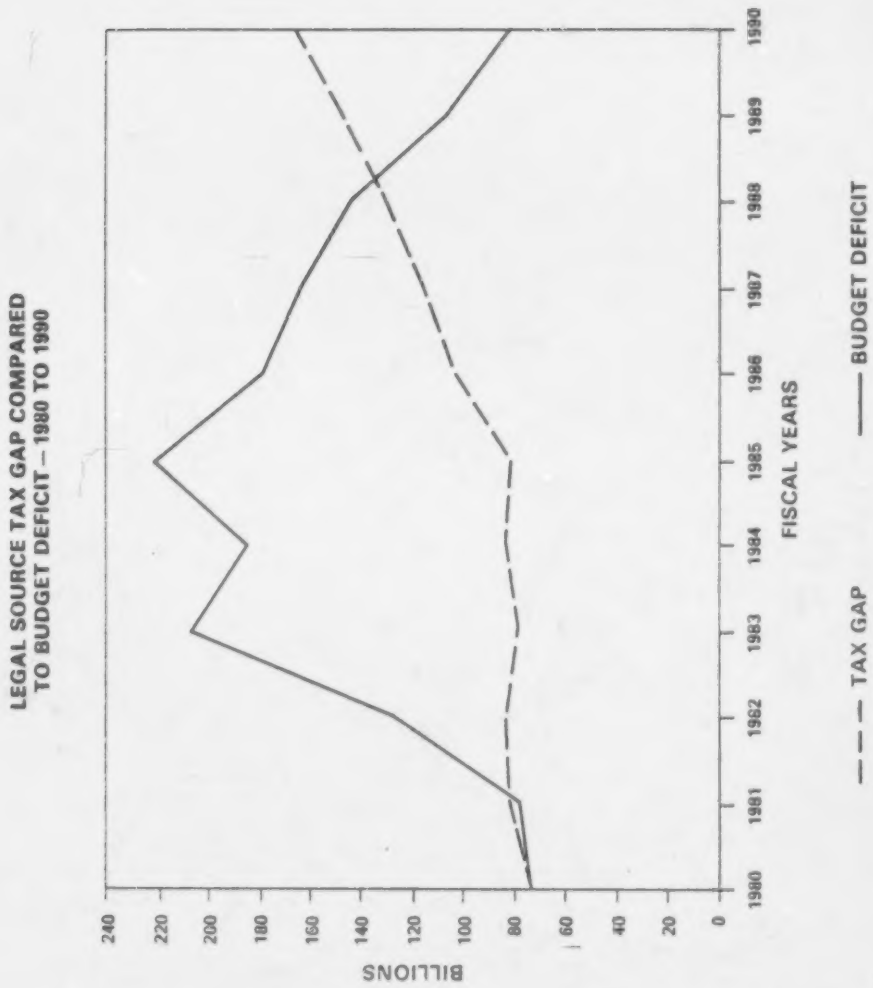


☐ SHADED PORTION INDICATES COLLECTIONS MADE BY IRS

NOTE: THIS CHART SHOWS RECEIPTS ONLY. IT DOES NOT SHOW THAT PORTION OF THE BUDGET FINANCED THROUGH BORROWING. ALSO, A SMALL PORTION OF THE EXCISE TAX COLLECTIONS ARE THE RESPONSIBILITY OF THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS, DEPARTMENT OF THE TREASURY.

ATTACHMENT II

ATTACHMENT II

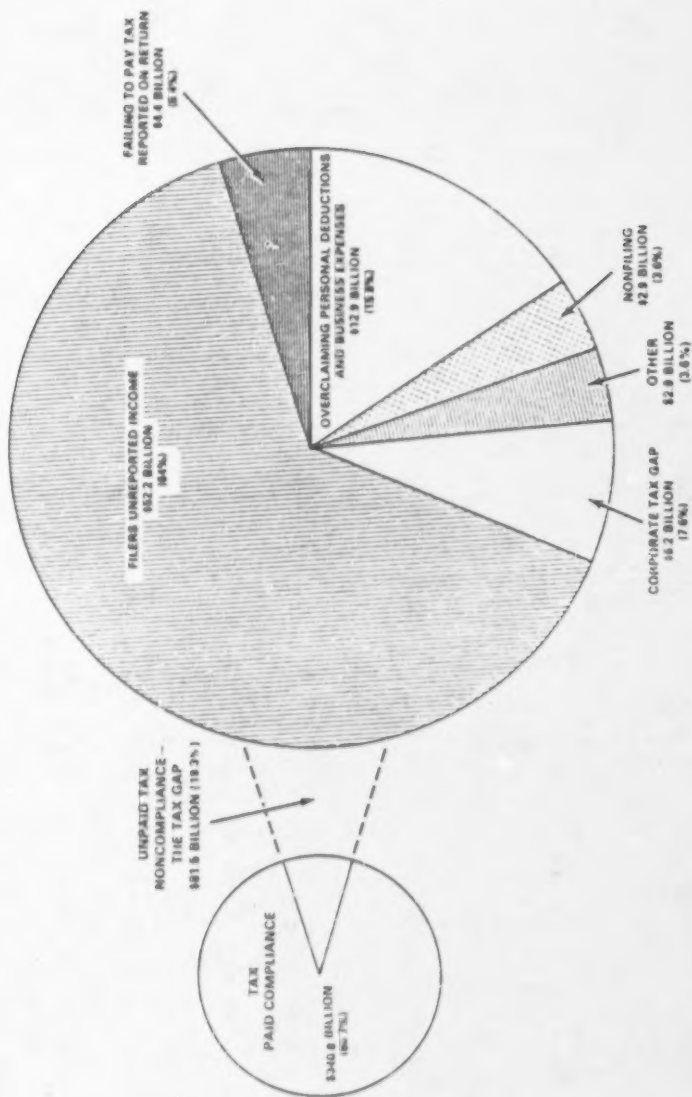


ATTACHMENT III

ATTACHMENT III

ESTIMATED INCOME TAX OWED IN 1981

TOTAL \$422.3 BILLION



ATTACHMENT IV

IRS Resources and Workload By Program
Fiscal Years 1976, 1984, 1986

Program	1976		1984		1986		Change 1976-86 Workload Staff year (percent)
	Workload (000)	Staff years (note a)	Workload (000)	Staff years (note a)	Workload (000)	Staff years (note a)	
Examination (note c)	123,361	28,164	129,258	28,050	136,788	29,518	+ 10.9 + 4.8
Collection Delinquent accounts	614	9,415	1,934	14,670	1,738	12,452	+183.1 + 32.3
Delinquent returns	281	1,849	618	4,389	564	3,469	+100 + 87.6
Returns com- pliance	248	442	10	135	10	135	- 96.6 - 69.5
Criminal in- vestigation	8.1	4,090	6,194	4,474	6,150	4,413	- 24.1 + 7.9
Information returns (note b)	462,000	1,700	692,000	3,651	1,046,000	4,972	+126.4 +192.5
Returns Processing	123,101	26,436	164,626	21,743	179,732	22,846	+ 45.2 - 13.6
Total IRS staff years		84,264		87,635		86,489	+ 2.6
Total IRS appropriation		\$1,691,520 (000)		\$3,325,630 (000)		\$3,511,200 (000)	+107.6

a) 1976 staff years are not adjusted to reflect organizational shifts.

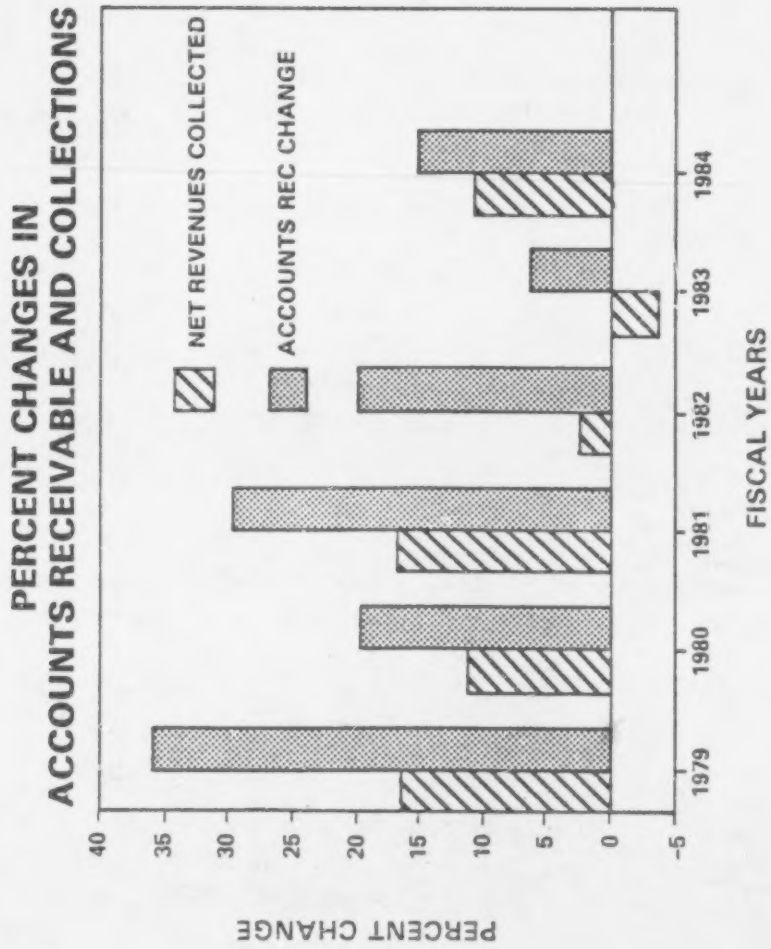
b) Information returns is a multifunctional program and some of the staff years shown for that program are also included in the staff years for the other programs listed above.

c) Examination workload is prior calendar year filings.

ATTACHMENT IV

ATTACHMENT V

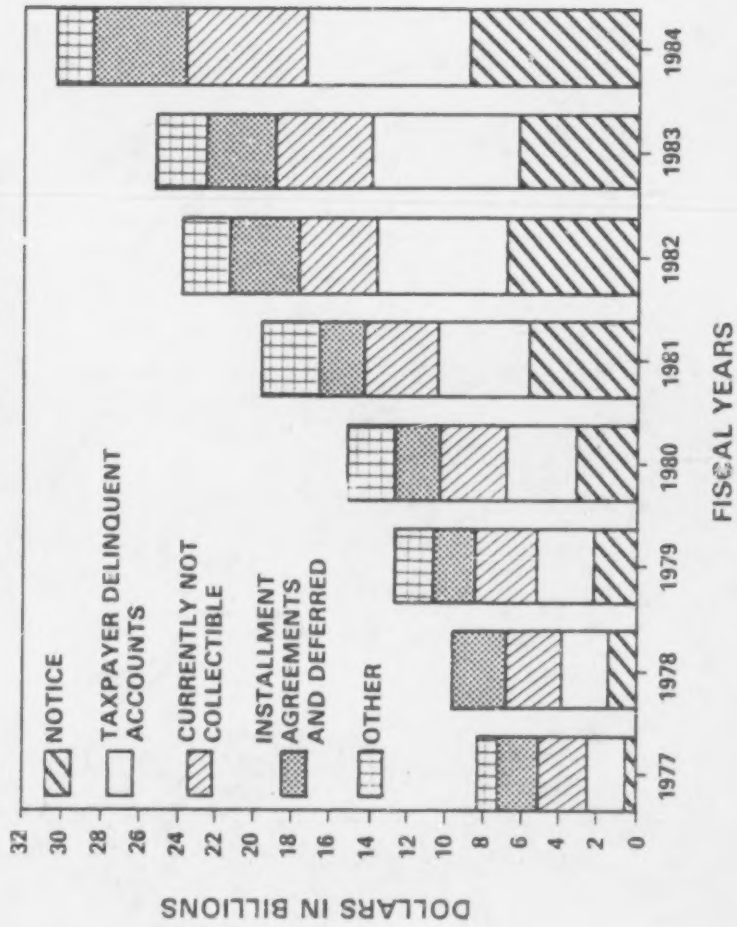
ATTACHMENT V



ATTACHMENT VI

ATTACHMENT VI

STATUS OF TAX ACCOUNTS RECEIVABLE AT FISCAL YEAR END



ATTACHMENT VII

ATTACHMENT VII

OPEN GAO RECOMMENDATIONS TO THE CONGRESS AND IRS
TO IMPROVE COMPLIANCE AND/OR IRS EFFICIENCY

<u>Congressional Recommendations</u>	<u>Source</u>
1. Impose mandatory withholding on agricultural employees.	B-137762 3-26-75
2. Adopt standards for determining whether an individual is an employee or self-employed.	GGD-77-88 11-21-77
3. Revise educational expense deduction to clarify tax status of educational grants.	GGD-78-72 10-31-78
4. Modify disclosure provisions of 1976 Tax Reform Act.	GGD-80-76 6-17-80
5. Modify summons provisions of 1976 Tax Reform Act.	GGD-80-76 6-17-80
6. Streamline legal review of criminal tax cases.	GGD-81-25 4-29-81
7. Make pension plan determinations by IRS mandatory for tax qualification.	HRD-81-117 9-30-81
<u>Recommendations to the Commissioner of Internal Revenue (note a)</u>	
1. Streamline legal review of criminal tax cases.	GGD-81-25 4-29-81
2. Clarify the description of information that corporations should report concerning the sale/purchase of stock.	GGD-81-81 9-30-81
3. Develop procedures to determine taxpayer filing compliance on pension payouts.	HRD-81-117 9-30-81
4. IRS should focus on increasing tax revenue as an interim enforcement strategy.	GGD-82-34 7-23-82
5. Better cost/tax revenue data are needed for resource allocations.	GGD-82-34 7-23-82
6. With better management information IRS' efforts against abusive tax shelters could be improved.	GGD-82-62 4-25-82
7. IRS needs to examine compliance impact of taxpayer assistance programs before making cutbacks.	GGD-82-12 4-5-82
8. IRS should determine the need for further consolidation of its telephone assistance sites	GGD-84-12 4-5-84

Source

- | | |
|---|----------------------|
| 9. IRS needs to determine whether benefits could be derived from expanding use of library audit tapes. | GGD-84-17
4-5-84 |
| 10. Treasury needs to properly account for Net Windfall Profit Tax Revenues. | GGD-84-15
6-18-84 |
| 11. IRS' Windfall Profit Tax Examination Program can be improved. | GGD-84-15
6-18-84 |
| 12. IRS needs to assure that Windfall Profit Tax has been assessed and paid on oil in multiple transactions. | GGD-84-15
6-18-84 |
| 13. IRS needs to develop effective procedures for examining net income limitation claims and adjustments. | GGD-84-15
6-18-84 |
| 14. IRS' reconciliation of Windfall Profit Tax returns may be needed. | GGD-84-15
6-18-84 |
| 15. IRS' Criminal Investigation Division needs to begin information gathering projects pertaining to the Windfall Profit Tax Program. | GGD-84-15
6-18-84 |
| 16. Reclaimed Tank Bottom Oil presents revenue loss possibilities and tax evasion opportunities. | GGD-84-15
6-18-84 |
| 17. Extending the time in which withholding adjustments can be made could improve Windfall Profit Tax administration. | GGD-84-15
6-18-84 |

a/ As of April 1985, IRS had many of these recommendations at various stages of implementation.

ATTACHMENT VIII

ATTACHMENT VIII

YIELD/AVERAGE COST ESTIMATES
FOR SELECTED IHS PROGRAMS
FISCAL YEARS 1976 THROUGH 1986 (note a)

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Examination											
Yield	\$4,500	\$4,100	\$5,000	\$4,900	\$6,300	\$6,700	\$8,600	\$10,000	\$10,700	\$10,400	\$10,600
Cost	601	632	675	720	780	836	904	970	1,020	1,125	1,126
Ratio	7.49	6.49	7.41	6.81	8.08	8.01	9.51	10.31	10.49	9.24	9.41
Criminal Investigations											
Number of Invest.	8,797	8,361	8,733	8,700	7,114	6,608	6,498	5,910	6,194	6,151	6,150
Cost	100	105	121	130	154	151	169	178	204	214	209
Cost per Invest. (note c)	11367	12558	13855	14942	21647	22851	26008	30118	32935	34791	33984
Accounts Receivable											
Yield	3,492	3,069	3,315	4,900	6,000	5,584	7,060	9,553	8,928	9,232	9,512
Cost	179	188	201	213	219	255	288	403	461	490	468
Ratio	19.51	16.32	16.49	23.00	27.40	21.90	24.51	23.70	19.37	18.84	20.32
Delinquency Investigations											
Yield	407	363	435	839	1,309	1,403	1,863	1,856	2,190	2,584	3,049
Cost	35	36	b/	62	73	91	103	129	139	129	130
Ratio	11.63	10.08	b/	13.53	17.93	15.42	18.09	14.39	15.76	20.03	23.45
Returns Compliance											
Yield	133	138	125	21	18	14	11	10	17	17	17
Cost	8	10	b/	6	6	4	4	5	4	5	5
Ratio	16.63	13.80	b/	3.50	3.00	3.50	2.75	2.00	4.25	3.40	3.40
Document Matching											
Yield	b/	b/	b/	b/	b/	b/	695	1,514	1,562	2,226	1,994
Cost	b/	b/	b/	b/	b/	b/	84	107	116	160	164
Ratio	b/	b/	b/	b/	b/	b/	8.27	14.15	13.47	13.91	12.16

a) Yield is measured in millions of dollars of net assessments except for the Criminal Investigations and the Accounts Receivable Programs. The Criminal Investigations Program is measured in total investigations; the Accounts Receivable Program is measured in millions of dollars collected.

b) Data not currently available.

c) Cost per investigation is total dollar cost.

Chairman PICKLE. Well, thank you, Mr. Finch. I appreciate your statement and your entire statement will be made a part of the record.

At this point, are we going to receive a report on your investigation of the Philadelphia review?

Mr. FINCH. We submitted that report to the committee staff on Friday, Mr. Chairman, and our understanding was that the thrust of our testimony should be directed toward the adequacy of budget.

We would be pleased to answer questions concerning the Philadelphia review.

Chairman PICKLE. We stated in our beginning statement this morning that I wanted to get a report on Philadelphia. We made that clear. And I am trying to see where during the day—this is as good as any. Let me ask the other gentleman, Dave, what is your last name?

Mr. ATTIANESE. Attianese.

Chairman PICKLE. I am going to ask you at this time to make a verbal report of the Philadelphia findings, a review of that center there, and then we will come back, Mr. Finch, to your questions.

Mr. ATTIANESE. All right, Mr. Chairman. We looked at two basic problems in the Philadelphia Service Center, two basic issues, the size of the correspondence inventory and the tape processing problems that they have had at the Philadelphia Service Center. We looked at several other minor issues, but I would like to just concentrate on those two issues if I can.

Chairman PICKLE. All right.

Mr. ATTIANESE. The Philadelphia Service Center's correspondence inventory has gone up significantly just as it has in all service centers. It is not unique to the Philadelphia Service Center. There were, and maybe still are, problems that affected all the service centers. The basic problem was the lack of availability of the IDRS, the integrated data retrieval system. It is an on line system that the people who respond to the correspondence can get on and look at the taxpayer's account, see what the situation is, and respond to their correspondence. That system has not been available to the extent that they expected it to be available. And the correspondence has been growing because they cannot get on the system to answer the correspondence.

Chairman PICKLE. Will you pull your microphone a little closer to you, sir?

Mr. ATTIANESE. Certainly.

The unavailability of the integrated data retrieval system was an aspect of the computer replacement system at the service centers. As part of that computer replacement system, IRS is rewriting the computer programs in a different language. That language causes the programs to take longer to run than IRS expected. For example, it is taking them longer than a weekend to do the weekend updates of the information on the integrated data retrieval system. So that starting the next week, people cannot get immediate access to that system to answer inquiries. There have been problems with getting access to that system is what I am trying to say, and that has caused inventories to go up across the board, not just in Philadelphia.

IRS has had problems with their Federal tax deposit forms. They have had problems getting the forms out to the taxpayers. They have had problems with the taxpayers filling out the forms incorrectly across the Nation. That has generated a lot of correspondence. That has caused the correspondence inventories to go up.

They have had staffing problems at the service centers from the standpoint not so much that there are a lot of vacancies there, but that they are filling vacancies with untrained people, unskilled people. It takes time, as I think the commissioner mentioned, and we agree, to get those people up to the point where they can effectively do their job. So it is a question of too few skilled employees in the Correspondence and Adjustment Branch, which is the branch that is handling the correspondence inventories.

IRS admits that all the new systems they have laid on the service centers are probably taking their toll. It had some impact on the service centers' ability to do their job because they are faced with all these new systems that they have to get acclimated to.

Those are problems that have occurred throughout IRS and affected all the service centers. There are a couple of other problems that seem to have exacerbated the situation in Philadelphia.

There was the implementation of the taxpayer correspondence study. Philadelphia was one of four service centers that implemented that study on a pilot basis. This is a study that was made to find ways that IRS could improve the way it handles taxpayer correspondence. The way Philadelphia implemented the recommendations from that study, as we have been told in Philadelphia, caused them additional problems. They did it in such a way that all the correspondence would come into the Adjustment and Correspondence Branch and be opened right there at the branch, by the tax examiners who were not trained to handle all the different kinds of correspondence they were opening, so it caused them problems and they had in the inventory shoot up.

At other service centers, the correspondence was being opened outside the branch and was being sorted before it came to the tax examiners. So there was some semblance of order, if you will, to that inventory before the tax examiners got it.

Philadelphia claims that that was a problem unique to Philadelphia. We do not know for sure whether the other service centers that pilot tested the study ran into that same problem. But Philadelphia claims it was a problem unique to them.

Another problem that caused the inventories in Philadelphia to rise were the tape processing problems they had in Philadelphia. The tape processing problem that got the most publicity involved the tape that had all the information on Federal tax deposits. The tape was sent to NCC, the National Computer Center, but could not be processed at the National Computer Center because header information on the tape was wrong, incorrect, could not be read, whatever. They asked the Philadelphia Service Center to replace the tape and that request was not timely handled by Philadelphia. That caused problems because those payments, those deposits, did not get processed in a timely manner and posted to the accounts in a timely manner. Erroneous notices went out to the taxpayers saying you have not made your Federal tax deposit. That generated a lot of correspondence. There is an estimate that 10,000 pieces of

correspondence were generated by that snafu, if you want to call it that.

That gets us to the second major issue we covered at the Philadelphia Service Center—the tape processing problems.

Chairman PICKLE. What was that problem on that last one?

Mr. ATTIANESE. The tape processing problems.

They had the problem with the FTD replacement tape. It was a problem where there were some controls lacking. It was also a problem where controls that were in place were generating information for management and management was not reacting to the information being generated by the controls.

The IRS internal audit when they looked into the tape processing situation at the Philadelphia Service Center, found that there was not just this one tape that had been processed in an untimely manner, but there were several tape processing problems at the Philadelphia Service Center. All those problems may have resulted in erroneous notices going out to taxpayers. In some cases, we know they have, and in other cases it is not definite, but to the extent that they did result in erroneous notices going out, you have got additional correspondence coming in.

They do have tape processing control problems at the Philadelphia Service Center. What we do not know, since we only went to the Philadelphia Service Center, is whether other service centers are having tape processing problems like Philadelphia. All we have seen in the papers and all the information we have is that there is a problem in Philadelphia, but there may be problems elsewhere. We do not know.

But there were control problems in the Philadelphia Service Center that caused tapes not to be processed in the way they should have been processed. There were also management problems in the Philadelphia Service Center. Problems were not being elevated to the right level of management in a timely manner, and management was not really sensitive, to the extent they should have been, as to what problems the processing problems were causing as far as relations with taxpayers.

That in a nutshell is what we found with respect to those two major issues, the tape processing problems and the correspondence inventory.

Chairman PICKLE. Does that complete your review, Mr. Attianese?

Mr. ATTIANESE. That completes what I have to say about those two issues, yes, sir.

Chairman PICKLE. We have your report and it is much more voluminous and we may make reference to this either this afternoon and again tomorrow I think I will ask you, Mr. Attianese, some questions since you are the last one to testify, and then we will come back and forth.

Did you make any statement concerning the other gentleman? Do you have a statement to make?

Mr. ABRAHAM. No, sir.

Chairman PICKLE. Mr. Attianese, after your group had gone to GAO and you found a lot of these inadequacies in staffing and procedure, tapes and so forth, did you find any other instances of

return processing problems at Philadelphia that should be brought to this committee's attention?

Mr. ATTIANESE. We did not find any instances. As we said in our report, internal audit found other instances of tape processing problems, and those are the problems that we cited in our report. We ourselves did not identify any other tape processing problems.

Chairman PICKLE. Well, according to your report, you identified five other serious processing problems that the IRS was aware of on March 4. And my question to you is did these delays in processing the returns and posting the tax payments result in erroneous delinquency notices going out to taxpayers?

Mr. ATTIANESE. Yes.

I want to make clear—

Chairman PICKLE. What are the four or five other serious problems that they had over and above what you went there to examine? What did you find? I do not have the report in front of me. But I know that you found them. Were they in magnetic tape processing? What were those areas?

Mr. ATTIANESE. I just want to emphasize once again that these were problems that were identified by the IRS internal audit. We did not find them ourselves.

One of the problems was that the Philadelphia Service Center did not timely process three magnetic tapes containing 2,171 employers' quarterly tax returns. That resulted, according to the internal audit, that resulted in 980 erroneous delinquency notices to 980 taxpayers.

Chairman PICKLE. I understand now from the report we received from our staff that in discussing the processing problem at the PSE, you did find some other areas, five situations had been brought to your attention. Magnetic tapes containing 2 employer quarterly tax returns from 2,171 employers were not processed for up to 6 months. The tapes were sent to the Internal Revenue Service by ADP but they were not processed.

Second, an unprocessed transaction tape and numerous problems with hardware, software, and procedures caused 30,000 erroneous Forms 941, delinquent notices, to be used, all right, used or issued. You found 13 remittance tapes were not timely processed and 116,088 deposits were not credited to taxpayers' accounts for at least 6 to 8 weeks.

Next, a systemic problem with the remittance processing system caused 1,111 blocks of payment information not to be processed. And, lastly, Philadelphia was not depositing unidentified remittances in accordance with prescribed procedures. As a result, taxpayers would not have proof of a payment to refute erroneous notices and levies.

Now, I do not know whether you found these as a matter of review or whether this was part of the internal audit, or is it a combination? Did you find these delinquencies, I mean these inadequacies when you were there?

Mr. ATTIANESE. Internal audit, the IRS internal audit uncovered those processing problems. We learned about it when we went in and did our audit and brought it to the subcommittee's attention.

Chairman PICKLE. Well, in your judgment, is the internal audit review correct?

Mr. ATTIANESE. Yes.

Chairman PICKLE. So these inadequacies do exist in Philadelphia?

Mr. ATTIANESE. Yes. Correct.

Chairman PICKLE. Do you know whether or not they have been corrected or are being corrected?

Mr. ATTIANESE. The information we have indicates that some steps have been taken to correct the problems. I cannot say whether all those problems have been corrected or not.

Chairman PICKLE. Well, the errors you found in Philadelphia, do you have any reason to believe that they are not also prevalent in other service centers in the country?

Mr. ATTIANESE. I have no reason to believe they are not also in other service centers.

Chairman PICKLE. You have no reason to believe that they are not?

Mr. ATTIANESE. They could be having the same problems in other service centers.

We only went to Philadelphia, and that is why I say I do not know what is happening in the rest.

Chairman PICKLE. I understand that.

Mr. ATTIANESE. Internal Audit is going to be looking at processing problems in other service centers.

Chairman PICKLE. To what extent is the Philadelphia office suffering from an overall lack of control of the tape processing system? Is the replacement tape issue we discussed at an earlier hearing we had, should we be concerned with this issue too on the tape processing system?

Mr. ATTIANESE. Controls have been put in place to take care of the replacement tape problem. But other controls are involved in these other tape processing problems. Whether those controls have been put in place, I do not know.

Chairman PICKLE. Well, I did not make it clear to you when I made reference to the tape processing system, I am asking you is the replacement tape issue we discussed at our early hearing the issue we should be predominantly concerned with about the Philadelphia office?

Mr. ATTIANESE. Is that the issue you should be predominantly concerned with? No, I do not think it is, not the replacement tape issue. I think that the issue is the control over computer tapes, not just replacement tapes, but just the overall control on computer tapes.

Chairman PICKLE. What recent changes in personnel have occurred at Philadelphia office? Have they added more people, gotten better people in? Have they filled all their positions that might have been vacant?

Mr. ATTIANESE. Are you talking about the computer section?

Chairman PICKLE. Well, the whole system.

Mr. ATTIANESE. Well, we know they have made changes, they have made personnel changes in the computer section, the section that is responsible for handling these tapes.

Chairman PICKLE. Do you know where the replacement staff came from?

Mr. ATTIANESE. I do not know exactly. They came from different places throughout IRS, other IRS locations across the country.

Chairman PICKLE. Are they permanent? Were they just sent in there?

Mr. ATTIANESE. They are temporary.

Chairman PICKLE. They were temporary.

Mr. ATTIANESE. Yes.

Chairman PICKLE. Well, I am going to ask you then what is the current situation in Philadelphia in light of all these reports and criticisms? Are the employees suffering from low morale? Could you tell?

Mr. ATTIANESE. I cannot say for sure. I think there is a morale problem in the Philadelphia Service Center. There would have to be with all the controversy about the Philadelphia Service Center. There would have to be morale problems.

Chairman PICKLE. Well, do you think now that the people in the Philadelphia area are receiving timely and adequate service?

Mr. ATTIANESE. I do not know whether I can comment on that, whether or not they are receiving timely service.

A lot of different services are being provided by the Philadelphia Service Center. If you want to talk about whether they are receiving timely and adequate responses to correspondence, I would probably say no, they still have a large inventory of correspondence that is over 45 days old so they are not getting timely service in that respect.

In other respects, I do not know.

Chairman PICKLE. The internal audit has gone there and found certain inadequacies and made recommendations.

Can you tell me whether the internal audit recommendations are in place?

Mr. ATTIANESE. The internal audit recommendations with respect to replacement tape problems, as I understand it, are in place. Corrective action has been taken to ensure that requests for replacement tapes are honored on a timely basis.

There are other control problems that have not been corrected yet.

Chairman PICKLE. Do you plan to do any further investigation review at the Philadelphia Center?

Mr. ATTIANESE. Yes, I do.

Chairman PICKLE. You do.

Mr. ATTIANESE. The Senate Finance Committee has asked us to do work at the Philadelphia Service Center, to look into some of the problems that we have been looking into for you, and also look at the shredding problems, allegations about shredding, the allegation of lost returns, look at all those things.

Chairman PICKLE. Do you have any information, based on your review up there, that there was shredding going on?

Mr. ATTIANESE. We have no information to indicate that there was shredding going on, no. No information to indicate that there was no shredding.

Chairman PICKLE. Do you have any information that it was hidden or misplaced somewhere?

Mr. ATTIANESE. IRS has admitted that there were some returns found in the women's lavatory, some returns found hidden in some—

Chairman PICKLE. Well, did you look into that question?

Mr. ATTIANESE. No, we did not.

Chairman PICKLE. I do not mean did you go to the women's restroom. [Laughter.]

Mr. ATTIANESE. No; we did not. We will be looking into the issue of lost and shredded returns. We are basically looking at the issue of whether there are sufficient controls in the service center to protect against a batch of returns being pulled out and shredded without anybody knowing about it. That is basically what we will be looking at.

Chairman PICKLE. Did you ask anybody about if they had heard of anybody doing any shredding? Did you look into that question at all or have you just stayed clear of that?

Mr. ATTIANESE. We did; yes. I mean we asked a couple of questions since we were up there, and all we got was that there was not any evidence that there were shredded returns.

But we did not nearly do the kind of work that we would need to do to be able to tell you that there was not any shredding. We just asked a couple of offhand questions.

Chairman PICKLE. Mr. McGrath, do you have any questions to ask this gentlemen or either one of the GAO personnel?

Mr. McGRATH. Thank you, Mr. Chairman.

Mr. Finch, let me see if we can glide through your testimony to find out whether or not I am clear on it. I glean from your testimony that you do not believe that the IRS is adequately staffed nor funded for its responsibilities in fiscal year 1985 or 1986; am I correct?

Mr. FINCH. That is correct.

Mr. McGRATH. And am I still correct in assuming that if they were given additional funds or personnel that you have no recommendations at this point as to where they should be put?

Mr. FINCH. I think it would be fairly easy to make some recommendations as to where they could be put. I think in harkening back to the Commissioner's statement this morning about where he thought some of the problems were, and that is where he would put resources initially. I guess the caution I would have is that it is very important to have a balanced program because, to the extent that you beef up examinations, that is going to generate workload for other service functions across the board. So I would have a caution in that regard as to where I would put the resources.

There are certainly some functions in IRS that generate much more revenue than others. On the other hand, there are other functions in IRS that perform very valuable services, such as taxpayer service, that don't necessarily generate revenue, but they play an important role, I think, in compliance.

Mr. McGRATH. We heard this morning that a 1-percent increase in compliance would reap about \$5 billion in revenue. Do you have any numbers as to how much additional spending in IRS, yields actual dollars?

Mr. FINCH. No, sir. But the recent figures that are available on examinations show a return of about 10 to 1. That is for every \$1

invested in the examination function it returns \$10 in additional tax and penalties.

Mr. McGRATH. And because the examination the area brings in a lot more revenue, that ratio would be diminished as we applied funds to other areas of the IRS function.

Mr. FINCH. Yes.

Mr. McGRATH. You made an interesting comment regarding the ability of the IRS to absorb additional personnel. I wonder whether you could elaborate a little further. From your remarks I infer a suggestion that indeed they cannot, No. 1. Further, those they are hiring today cannot fulfill their responsibilities immediately, and that says something about the entire operation of the bureau. I am wondering whether or not you could get into that.

Mr. FINCH. I think you may be taking it a bit further than I intended. My intent was to state that there has to be a point where IRS cannot effectively recruit, train, and assimilate more resources into its program. I am not sure where that point is. IRS should have a pretty good idea.

The suggestion that I kind of had in mind was that perhaps the subcommittee could ask IRS to price out the revenue benefits that would accrue at different levels of funding, say, in 500 staff-year increments up to a total, say, of perhaps 5,000 staff-years. And that should give the subcommittee a pretty good idea of what an optimum level of resources would be without running the risk of giving IRS more resources than it could effectively bring to bear in the short term.

Mr. McGRATH. One final question: We have heard a lot today about productivity and productivity being increased due to computerization and systems analysis. I am wondering whether or not you believe that the IRS current computer system and the capacity to which it is running at the present time can or will ever meet the work load for 1986 and beyond.

Mr. FINCH. That is a tough question. I think there are some serious issues surrounding the topic of capacity—particularly in terms of the service center system. I am not sure that I can quantify that. We have some work ongoing at this time which, hopefully, will shed some light in terms of the capacity of the systems as planned and whether or not they may need additional capacity.

Mr. McGRATH. We would be interested in getting that information as it becomes timely and I thank you for your testimony.

Mr. Chairman, I yield back the balance of my time.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman. Mr. Finch, when you started looking into the Philadelphia situation, did you go to other service centers so that you would have a proper perspective on that which was being done in other areas?

Mr. FINCH. No, sir, we did not. And one reason we did not was because of the time constraints. The subcommittee asked for a very quick turnaround and was interested primarily in Philadelphia. The internal audit work that has been done has discovered some deficiencies that may well exist at other service centers. Internal audit has expanded the scope of its work to include, I believe, nine additional service centers. They are going to be looking for system-

ic problems. They are going to be looking for your iceberg, sir, that you referred to earlier.

Mr. SCHULZE. That is the direction I was going. Of necessity, yours was a fairly cursory examination. You did not have time to go in depth, and your main focus was on the tape situation, which you addressed very thoroughly. In the process of that investigation, knowing what you know now about the internal audit and its findings, are there any other recommendations you would make to this committee?

Mr. FINCH. I think the recommendation that I would make to the subcommittee is it maintain its oversight posture until it was sure that there is not an iceberg below the tip.

Mr. SCHULZE. In your opinion is there a potential for severe problems in other parts of the country; it seems to me one of the problems in Philadelphia was the lack or apparent lack of communication among the various executives and executive levels.

Mr. FINCH. Yes.

Mr. SCHULZE. This apparently is brought out by the situation now in Texas where that information did not funnel up to the central office. How apparent was this communication breakdown in your study or what recommendations would you have along those lines?

Mr. FINCH. I think I can cite three common characteristics in the problems that we noted and that internal audit had noted based upon our discussions with people at the Philadelphia Service Center.

I think three characteristics are fairly common to all of the problems. One characteristic was that the problems were not promptly elevated to management. Management was not aware. In some instances controls were in place that management did not pay attention to that they should. In other instances it was a failure to communicate, I think. So that is one characteristic, problems not being properly elevated to management.

The second characteristic is I think there was a failure to recognize the impact of the problem, the impact of the problem on district operations. The service center was aware, in many instances, that erroneous notices were going out. They did not take action to notify the district offices that the notices had gone out and that the districts could probably expect calls from some taxpayers. Neither was attention paid to the impact on the taxpayers themselves and the frustration and the aggravation that IRS notices sometimes create, particularly if they are duplicate notices or erroneous notices. So that is the second characteristic.

I think a third characteristic we saw was that, even after the problems were known, the causes of the problems were not being actively sought, or a great deal of time lapsed before public attention pushed IRS toward action to identify causes of the problems.

Mr. SCHULZE. You say that there were controls in place, but that, at times the information was sent up to the next level and simply ignored. At other times information was never passed on. This series of circumstances evolved into the immediate tape problem. Would you share your observations about the problem of properly trained employees in the computer area as well as those who were handling the tapes in the Philadelphia situation?

Mr. FINCH. I think the service centers' returns processing function has been a very lean function for a number of years. I think IRS has pointed to productivity gains through technology, and what have you, in the service center area and used those staff years, to increase staff years of other functions without necessarily having to ask for an overall budget increase.

I think they have been forced to do that, quite frankly, by the position the administration has taken over the past few years. Because of that, I would not characterize the service centers as having an excess of people. This really exacerbates the problem when you have turnover because then you have to replace an experienced person with a new person who does not have training or whatever, or you have to detail someone in. This is robbing Peter to pay Paul because you are taking that person from another function where they are needed.

Mr. SCHULZE. Do you agree that right now it might not be worth our effort to put extra personnel in there to cure the backlog problems? It seems to me that one of the things that we should be looking at now is extra personnel even if only for a temporary period until this transition period is over and the backlog is once again manageable. Each time we have one of these problems a great backlog results which then expands and explodes.

It seems to me we should be able to put some extra personnel in there and solve more immediately the backlog problems. Do you have any thoughts on that?

Mr. FINCH. I would agree with you, sir. I think they could use some extra personnel. I think what has to be done is that you have to try to get the most experience that you can get in the personnel that you put in there. I mean, if you have to go somewhere else in the service to get them and put them in there, fine. In the meantime, we can be training some people.

Mr. SCHULZE. Yes. And put people with less training in those other jobs.

Mr. FINCH. Yes.

Mr. SCHULZE. How can we begin today to turn the IRS around since they have been somewhat understaffed, just to meet the demands of tomorrow and beyond? Can it be accomplished through extra personnel? Do you think the training facilities need expanding? Are the training programs adequate or inadequate? Where should we start?

Mr. FINCH. That is a very broad question. I think the place to start is with additional resources. IRS does not really have, for a lot of the functions, management information which enables you to make marginal cost decisions. In other words, you do not know what you are operating at on the margin. The examination function does. Very few of the other functions do. Notwithstanding, I think they are so far behind in terms of resources versus the workload that they have, that you run very little risk of hitting the law of diminishing returns by adding resources virtually anywhere.

Mr. SCHULZE. In response to Mr. McGrath, you said that morale certainly would suffer under the conditions that are there presently. But did you have an opportunity at all to look at production standards and whether or not they build pressure which is too

great. Is there a tendency to push an employee to do perhaps a little more slipshod work to get it done and get it off his desk?

Mr. FINCH. No, sir, we did not.

Mr. SCHULZE. You did not look into that?

Mr. FINCH. No.

Mr. SCHULZE. You did not look into morale as such either, did you?

Mr. FINCH. No; I would agree with Dave. Dave made a comment earlier that it seemed safe to assume that there is a morale problem. I would tend to agree with that, even though we did not look into it specifically.

Mr. SCHULZE. The large correspondence backlogs, at least in Philadelphia, appear to have been caused by the computer tape failure. With the additional problems discovered in Philadelphia, do you see an end to this correspondence backlog?

Mr. FINCH. Well, hopefully, there will be an end. I do not see an end in the short term, I do not think. I think, in fact, we even saw an IRS document that indicated that at least at the time the document was prepared that IRS thought it would be toward the fall of the year before the correspondence inventory was reduced to what they considered to be a manageable level.

Mr. SCHULZE. One final question, Mr. Finch. In your opinion, was the Philadelphia tape situation the tip of the iceberg, or do you think it was just an isolated little piece of ice floating along in the ocean?

Mr. FINCH. I honestly do not know. Dave gave a very good summary of some things, some causes, that we were able to identify that contributed to the correspondence inventory, and a point that he made was that several of these causes do pertain to all service centers. They are not just unique to Philadelphia. And given that, I do not know.

I am curious and look forward with a great deal of anxiety to seeing what the IRS internal audit finds.

Mr. SCHULZE. You are charged by the Senate. In other words, will you be visiting any of the other service centers?

Mr. ATTIANESE. They just asked about Philadelphia also.

Mr. SCHULZE. Thank you gentlemen. Thank you, Mr. Chairman.

Chairman PICKLE. Well, Mr. Attianese, we may very well be going into these other centers. It is not likely that Philadelphia is just Peck's bad boy alone. If these problems are there and they are basically one of a computer system, then they might be in existence anywhere in the country.

It seems to me that a point was made this morning which we have overlooked. The IRS is going to ask for \$31 million more from the Appropriations Committee this year to work themselves out of some of their difficulty. They really are asking for it to help get more productivity with respect to the computers that we have now, just to come out of the mess we are in, the snafu we are in.

It does not take into account the fact that they are going to need more money for computers next year. Somewhere in January or February they are going to put another new addition of computerization into this whole process. Now, if they are not able to handle what they have now with the present personnel and they put a new system in next year, how are they going to get more productiv-

ity? Do either one of you think they will have the kind of productivity increases next year that will handle things?

Mr. FINCH. I think that is an excellent question to ask the Commissioner.

Chairman PICKLE. I was going to ask the Commissioner this morning, but we got a roundabout answer. I am asking you: do you think that it follows that we will not have great difficulty when we add more computerization again next year with less funds and less personnel?

Mr. FINCH. More computerization with less funds and less personnel, more problems.

Chairman PICKLE. Well, now, Mr. Finch, you just flat out said to begin with the IRS needs additional resources to more effectively administer our Nation's tax system. You do not make any bones about it. You just come forth and say it is a fact. I imagine you are correct. We could not get that kind of a clear statement from the Commissioner this morning because he wanted to kind of waffle around that issue, and I accept that because he is in a difficult position.

But you go on to point out now about 10 different things with respect to the review we have had that shows we need more personnel, including the fact that 20 percent of the people are cheating now because they do not believe somebody else is paying their full share and therefore they ought not have to either. And, therefore, the rate of noncompliance is growing, the tax gap is increasing, and we collect less revenue because of it.

Now, is it not correct, then, that the only way we can correct that is to try to get enough personnel that can handle the matter?

Mr. FINCH. I think that is correct, sir.

Chairman PICKLE. And we are not doing it by trying to get more productivity from machines that are not working. Or at least we do not have enough people trained to work them. And so it seems to me like we are going about this in a rather backward manner.

If we were to make additional funds available, where would additional staff be used, in your judgment, best used?

Mr. FINCH. I think they could be used virtually across the board, sir.

Chairman PICKLE. In all categories?

Mr. FINCH. There are functions that produce revenue. There are functions that deal more directly with compliance. I used taxpayer service earlier as an example of that.

Chairman PICKLE. Now, we have had years of understaffing. After these years of understaffing, how many additional personnel can the Internal Revenue practicably absorb at one time? That is in terms of hiring and training and putting qualified employees to work productively.

You said they ought to have more people, but they ought not to hire any more than they can properly handle. What percentage of personnel do you think they could add?

Mr. FINCH. I am really not sure, sir.

Chairman PICKLE. That is another question I should ask the Commissioner.

Mr. FINCH. Well, my suggestion there was that perhaps what you could do was ask the Commissioner to price out for you the cost

versus the benefit of increases in staffing in 500 staff year increments up to a total of, say, 5,000 staff years.

Chairman PICKLE. We have asked that of the Commissioner, and we have received some information in response to it. We are going to be submitting a lot of other questions. We will be doing the same to you.

From your own personal standpoint, do you believe that the Internal Revenue Service's current computers have the capacity to meet the workload for the 1986 year and beyond?

Mr. FINCH. I think there is some question, sir. I think there is some question as to whether or not there is sufficient capacity. We have some work underway. Hopefully, we will be able to answer that question more specifically.

Chairman PICKLE. We have a vote on and I am trying to cover as much territory as I can. Do you have anything you want to volunteer to us before we take a recess here in addition to your report?

Mr. FINCH. No, sir, I think I have covered basically the points that I wanted to make.

Chairman PICKLE. There is something I wanted to ask you. You said that the Internal Revenue Service made their report and they indicated that with respect to delinquency that they had reported on collections \$8 billion that they were behind. And you said the more accurate figure was \$30 billion.

This is on page 16 of your report. You said according to IRS tax revenue and active taxpayer delinquencies would be four times the 1976 level.

Now, it goes on:

On this basis IRS reported \$8.5 billion in delinquent accounts at the end of fiscal year 1984, but the actual amount of total accounts receivable outstanding was \$30.1 billion.

And then it goes on to explain where that \$30.1 billion comes from.

Why would the IRS report on \$8.5 and you said over \$30 billion in addition to that?

Mr. FINCH. Because the \$8.5 are the ones that they consider active, more active than the other categories—

Chairman PICKLE. All the other categories they just do not look at. They do not report that.

Mr. FINCH. Right.

Chairman PICKLE. Well, that is not being fully honest about giving a report to us, then. I will ask the Commissioner about that, too, Mr. Finch, whether it is actual or whether it is accounts receivable.

I think you have given us a good report.

Mr. FINCH. Thank you, sir.

Chairman PICKLE. I think the report that the GAO gave us is better than the testimony this afternoon, and I regret that because the shortness of time has not given you a chance to really go into detail of all of what you found out there.

Apparently the staffing is inadequate. Management controls were relaxed at the Philadelphia office. Morale is low. We may have just touched the tip of the iceberg in this whole service center problem. So we may well be asking you to make audits of the vari-

ous service centers throughout the United States and return specific recommendations.

We certainly are not comfortable in this committee trying to produce facts to indicate that we are going to increase our personnel. Nobody in office likes to say we are going to hire more Internal Revenue collectors.

Mr. FINCH. Right.

Chairman PICKLE. And yet if the return is 10 to 1 or 15 to 1, what option do we have? And I also say we must have greater honesty on the part of IRS and the administration as to their needs or else tax compliance is going to get lower and lower.

Well, I must pause at this point. The subcommittee will recess for 10 minutes.

[Brief recess.]

Chairman PICKLE. We will ask the subcommittee to please come to order. We are privileged now to receive testimony from two former Commissioners of the Internal Revenue Service, both of whom have distinguished themselves and who are personally known to us and whose service has been very valuable to the U.S. taxpayers. We are pleased to receive their statements, and they have both submitted prepared statements and I am going to ask that both statements be included in the record in their entirety.

I am going to ask first Mr. Sheldon Cohen, former IRS Commissioner, if he would comment about this matter, and then we will go to Mr. Alexander.

STATEMENT OF SHELDON S. COHEN, ESQ., MORGAN, LEWIS & BOCKIUS, WASHINGTON, DC

Mr. COHEN. Thank you, Mr. Chairman. Just a word or two at the beginning, I think that we have an odd situation. We have a tremendous budget deficit. We have a Congress that is thrashing about trying to resolve ways and means of reducing that deficit. And at the same time we have the Office of Management and Budget holding the IRS to less personnel this year and in the coming year than they had in the prior year, which, I have to say, was inadequate.

We have a Revenue Service that has been one of the administrative gems of the Government for years. It runs a pretty good shop. It is in danger of deteriorating and it is deteriorating. We have an audit level today projected of 1.2. If you look just over a 10-year period, it is down from about 2.5. And if you look over a 20-year period, that is down from something close to 5 percent. Now, you can almost trace the line of that fall in the audit percentages to the fall in the compliance level. People recognize it. The magazine articles recognize it. You hear talk about it on the streets. "There is very little chance that you are going to be audited, so why comply?"

Chairman PICKLE. Mr. Cohen, the Commissioner this morning said that really was not an adequate figure. You could not compare the percentage of audits from 2 or 3 or 4 years ago, from 4 percent down to 1.2, that it really was not relevant. Did you hear him say that this morning?

Mr. COHEN. I heard him say that, and I would agree with him to some extent. Since the design of TCMP—which was done while I

was in office—we had a 40-some percent no change rate in audits. After TCMP it fell to 26 by the time I left office. And then, of course, it has been falling since that time.

So, I will grant him that 1.2 in that sense is slightly more effective than it would be if you had a larger no change rate. Nevertheless, in absolute numbers of audits we are falling. We do not audit as many returns as we did 10 or 15 or 20 years ago.

The absolute number of people contacted by revenue agents is low. And people respond when they see a traffic cop on the street; they slow down. If people do not see the traffic cop, they speed up. The same thing is happening with tax returns. The same thing is true in the collection area. Mr. Finch hit the number pretty hard. It is \$30 billion in uncollected accounts, they have reported only the \$7 or \$8 billion because that is the only amount that they are capable of handling. They cannot handle the workload with the current personnel. Well, that does not resolve the issue. The delinquent accounts are still there. Those people have still not paid that tax. The other side of that issue is that here we have a voluntary system that relies on people's good will. When they call the IRS, they cannot get the office. The line is busy or it is not answered.

I defy you to call any revenue office, collection office or a taxpayer's assistance office—during filing season you cannot get through at all. But if you call this week, I would suspect it would be several times before you would get through simply because they do not have enough personnel to handle those phones.

One of the things that has happened recently that I have noticed in many offices is the decline in the support personnel. The Commissioner, in attempting to make do with the little that he has, has tried to put emphasis on enforcement personnel, and that is logical. I would probably do the same.

On the other hand, if the enforcement personnel do not have enough secretaries and clerical personnel to get their work out, we are not gaining very much. And I have been in offices where the personnel have told me, very frankly, that they have to wait 1 week or 10 days for something to be typed.

Indeed, most of the material we receive from revenue agents these days is no longer typed. We hardly ever get any typed material. It is all handwritten. When the revenue agent has good handwriting, you are all right. When the revenue agent's handwriting starts to get a little tired, you have a little trouble following it.

Now, that is not as it ought to be in a system that is trying to be as effective as it should. The last sentence in my prepared statement is as apt as I can put it—we have a fine organization staffed by good people, overworked, dealing with increasing complexity. And the administration—and I do not mean the IRS administration; I mean the OMB administration—asks them to do more with less. And I have been quoted as saying that is silly, and I do believe that is silly.

Chairman PICKLE. I hear you, Mr. Commissioner, and I think the committee members would agree with you. I get disturbed when we get half answers or no answers or rather evasive answers from the IRS leadership both with respect to the number of audited reports and collections.

Mr. COHEN. In fairness to them, as I understand it, Mr. Pickle, I understand that the Commissioner when he made his request of the Treasury Department and of the OMB did make a request for increased personnel which was declined.

Chairman PICKLE. Yes; our committee, then, has to make the decision, do we just accept that?

Mr. COHEN. Well, if I were you I would not.

Chairman PICKLE. No.

Mr. COHEN. This committee has before asked them—

Chairman PICKLE. If this committee believes that something else should be done and must be done, then it seems to me like we ought to have some kind of request from the administration that it ought to be done and not for everybody just to sit on their hands and look the other way and say they hope they understand the facts.

Mr. COHEN. Well, unfortunately, they were in the position this morning of defending the undefensible. Their position is undefensible.

[The prepared statement follows:]

STATEMENT OF SHELDON S. COHEN, ESQ., MORGAN, LEWIS & BOCKIUS, WASHINGTON, DC

Mr. Chairman and members of the Subcommittee on Oversight: I appear before you today at your invitation. I do so in my individual capacity; the views I will express are my own and do not represent those of my firm or any of its clients.

I have appeared before this Committee many times. I admire this Subcommittee's role in searching for ways to make our Internal Revenue system work more smoothly and more equitably.

Today I am here to criticize the adequacy of the IRS budget. I do so more in sorrow than in anger. However, I am angry at the attitude of some people in this and prior administrations who appear to view the IRS budget as just another agency to be slashed. The IRS is unique. It supplies the resources to run our government. We should ask the same questions of Commissioner Egger as we ask of Secretary of Defense Weinberger. "How much do you need to do a first rate job?" We should not ask, "How little can you get by on?"

I know and admire Commissioner Egger. I know he requested greater resources from Treasury and OMB. The Budget makers in this Administration however cut the IRS Budget. The Service has not been given adequate resources to do the increasingly difficult job of collecting all the revenue the tax system was designed to collect.

For a great number of years now through, certainly the Carter and Reagan Administrations, a period of eight years, we have had steadily falling audit examination rates. In the last 10 years the rate of return audits has fallen from 2.55% to 1.2%. Fifteen years ago the audit rate was about four percent. I believe that tax compliance has fallen about in proportion to the fall in audit levels. I certainly can tell you that 1.2% is terrible—perhaps approaching disastrous. People have lost confidence in our tax system and its fairness. Compliance shown by TCMP is falling. This is no time to reduce the percentage of returns examined.

We are currently fighting to balance the budget. Some argue that the cuts effect those of our citizens least able to bear pain. At the same time we are doing almost nothing to close the acknowledgeably high tax gap. OMB says that next year it will authorize 2,500 agents. Will they? Look at their record. It appears that in alternative years they cut and then raise the IRS budget. OMB seems to feel we won't notice if they cut personnel and enforcement one year and then they brag about a small increase later.

The audit problem is a constant one. Each year the population grows—each year business gets more complex—and each year the code is made more complex. (Let us hope this stops this year). Therefore, each year we do not increase audit staff years, we fall further behind.

So it is with collection and other related work. Has anyone on the Committee tried to call an IRS assistance telephone number—even in the non-filing season? The phone rings and rings and there is no answer, because they are short handed—

or the line is busy. The same is true in dealing with the collection people. Is this the way to run a system which so much depends on voluntary compliance and the good will of the taxpayer? Of course it is not. The inventory of all types of accounts grows each year. A year ago the total of uncollected taxes shown on returns was \$26 billion. This year it is \$29 billion.

The increasing complexity of the tax system also demands more tax assistance in the problem resolution area. With the attempt to match more and more data and with the attempt to assert the various penalties that apply to late filing or late deposit or payment, more and more discrepancies come up. These must be corrected by human beings—machines won't do it—and there simply are not enough human beings to do the complex job.

I also notice that most IRS offices are woefully short of secretaries and clerical staff. Often professionals cannot get the work out because they lack the support staff.

Thus, we have a fine organization staffed by good people—overworked, dealing with increasing complexity. The Administration asks you to give them less to do more. I believe I have been quoted as saying this is "silly."

Chairman PICKLE. Well, Mr. Alexander, we are pleased to have you with us again, and I would be glad to hear from you.

**STATEMENT OF DONALD C. ALEXANDER, ESQ., MORGAN, LEWIS
& BOCKIUS, WASHINGTON, DC**

Mr. ALEXANDER. Thank you, Mr. Chairman. Mr. Chairman, the Commissioner, while in office, has to be a good soldier. Of course, you do not have to be once you have left office. And, Commissioner Egger, I am sure, asked for additional money, additional resources for IRS, and did not get it. So he had to depend on what he is taking to the Congress. That does not mean you have to accept it. It does not mean you cannot, here at the Hill, give IRS more. And you certainly should.

Now, first, a couple of things said earlier seem to be laid at IRS in the middle seventies. The middle seventies had nothing to do with the computer problems that the IRS is having right now. We tried to get a new, upgraded system. We did not get it. The Appropriations Committees would not let us have the money. That did not mean that they had to put everything in last November and run without a parallel system. That is going to create real problems this filing season, as you have heard, and I am sure this committee in the continuing exercise of its oversight function will wonder how much the ultimate cost will be, cost in overtime and also cost in pulling all of those people out of district offices, that you heard about this morning, and putting them in the service center. Were they performing badly needed work in the districts? If so, who is going to do that work? So, I am glad you are having this hearing. I just wish that this committee would have continual and regular oversight hearings. The IRS needs it.

It needed it when I was in office. It needs it now. The Commissioner mentioned a decline in the no-change rate to 16 percent. He pointed out correctly it was 28 percent in 1974. It was 41 percent in 1969. The decline in the no-change rate may be due in part to better audit selection. It may be due to worse compliance.

I agree completely with former Commissioner Cohen, that 1.2 percent audit coverage is woefully inadequate. It was 2.4 percent in 1974. The magic 5 percent that we have heard a lot about consisted largely, as I recall, of single issue audits. I do not believe we want to build up numbers for single issue audits again, but I think that

we can do a much more comprehensive job and you need to do precisely that.

Taxpayer service is woefully insufficient. I agree with what former Commissioner Cohen said. I see no excuse whatever for a reduction of 156 average positions in an already too weak and too limited organization.

Returns processing, you questioned Commissioner Egger about that thoroughly. We need not go into that anymore. Collection, we have discussed that one thoroughly also. But let us talk about something that has not been discussed; the Internal Revenue 1986 budget claims that it is strengthening the general enforcement program. Now, that is what we used to call the intelligence division's, now criminal investigations division's program is for those who evade their taxes but are not drug dealers or members of organized crime.

If you look at the numbers behind that assertion, you find they do not bear it out, that instead enforcement of the tax laws is being weakened, no strengthened. And performance of IRS's regulatory role with respect to employee plans and exempt organizations is also being weakened. Audit coverage under this budget is down to 0.75 percent, not even 1 percent of plans.

Resources have been decreased. The decrease is comparatively small, but it is real and it will have a very major adverse effect upon Internal Revenue's ability to perform its massive function of reviewing every single qualified retirement plan, which must be amended; all of them must be amended to comply with REA, the Retirement Equity Act, DEFRA, and TEFRA.

Also, finally, for some reason the budget reduces the technical function, a decrease of 69 average positions. Now, the Internal Revenue does not publish enough revenue rulings and revenue procedures now. It should publish many more. It does not give prompt enough responses to the many taxpayers who have questions about these mystifying laws that we have been enacting almost every year. And the decrease in its ability to respond is a long step, like the others, in the wrong direction.

Chairman PICKLE. Does that complete your statement, Mr. Alexander?

Mr. ALEXANDER. Yes, sir.

[The prepared statement follows:]

STATEMENT OF DONALD C. ALEXANDER, MORGAN, LEWIS & BOCKIUS, WASHINGTON, DC

I have said numerous times, and I now repeat, that the Internal Revenue Service is a fine agency that has done a difficult job well. The proposed 1986 budget will, in my judgment, strain IRS' capabilities and weaken tax administration.

In view of IRS' increased costs and increased workload, the proposed staff and funding reductions would impair IRS' capacity to meet its responsibilities; to advise taxpayers of their rights and responsibilities and assist them to perform their obligations; to communicate effectively with taxpayers and be responsive to their inquiries; to process tax returns promptly, efficiently and correctly; to examine tax returns and enforce return filing requirements; to enforce the tax laws against those who evade them; to maintain an adequate and fair appeals process; to litigate tax cases; to interpret the tax laws in a timely and reasonable manner; and to perform its important regulatory role with respect to employee plans and exempt organizations.

In almost every category, the 1986 budget falls far short.

I have long believed that a primary responsibility of IRS is to assist taxpayers to comply with their obligations under the law. Thanks to our overly complex Internal

Revenue Code, the long form 1040 (which most individuals taxpayers use) is itself very complex and hard to understand by ordinary citizens. IRS should do a better and more comprehensive job of taxpayers assistance and should not rely solely on the telephone. While telephone banks are efficient methods of providing mass advice of a generalized nature, they do not adequately substitute for face-to-face contact, or face-to-face assistance to taxpayers who genuinely need help in preparing their tax returns. IRS should provide such help.

Even in the face of already inadequate taxpayer assistance, the 1986 budget proposed a decrease in these resources, which is apparently based upon a substantial projected decrease in the assistance intended to be provided. Clearly a system that would turn away a substantial number of taxpayers seeking aid is inadequate.

As to another important area of IRS responsibility—returns processing—the 1985 filing season has not been a jewel in IRS' crown. The Philadelphia story needs no retelling. Unfortunately, it appears that those responsible for the 1986 budget have failed to learn 1985's lesson. Despite a projected increase in workload, the budget proposes a substantial decrease in returns processing positions. This is not the way to assure future successful filing seasons.

A comprehensive and effective program of examination of tax returns, the securing of returns from those who fail to file, and prosecution of tax evaders is virtually important to assure the many Americans who pay their full share of our tax burden that those who do not met their obligations will be called upon to do so.

Audit coverage of 1.2 percent, predicted for 1986, is grossly inadequate. IRS is examining too few returns now. The inadequacies of the present examination program extend across the board. A decrease in an already insufficient program can be reasonably expected to result in a further decline in compliance and an increase in the tax gap.

The budget request states that commencing at the end of 1986, IRS will be able to add 2,500 examination positions each year for three successive years. First, a question could be raised as to the firmness of this commitment. Will those proposing the 1986 budget necessarily be in a position to develop the post-1986 budget? More important, why wait? Clearly, audit coverage, which has declined substantially in recent years, is at a level inadequate to provide an effective deterrent against cheaters. Additional examination resources should be provided now, not later.

Another witness apparently believes that the proposed 1987-89 augmentation of examination resources is limited to revenue agents and should be accompanied by corresponding increases in support staff as well as increases in such areas as appeals, litigation and collection. From a quick reading, I am unable to find language that would limit the proposed increase to revenue agents or exclude support staff. As to appeals and litigation capabilities, IRS' resources should be increased in areas besides examination. However, it takes time before an increase in examination resources triggers increases in the workloads of those who handle appeals, those who litigate, and those who collect taxes found to be unpaid and overdue. Furthermore, like others who are no longer with the Internal Revenue Service, I am unable to speak with certainty whether and to what extent the appeals function, as now constituted, needs additional resources in order to handle the increased workload which presumably would begin to flow—months later—from the activities of the newly-hired and trained revenue agents and tax auditors.

IRS' collection resources should not be reduced. While I am a firm believer in the Automated Collection System (the concept having been generated, as I recall, during my tenure), ACS can't do the job alone. I am sorry to see that Collection's delinquent returns activity is being reduced and that collection resources are being significantly weakened. This is not the way to balance the budget.

Dealing with tax evaders is another important part of the IRS mission. Although the budget document asserts strengthening of the general enforcement program (directed at tax violators other than drug dealers or members of organized crime), the numbers do not bear this out. This important program has been neglected in recent years, and we should no longer continue the neglect.

The Internal Revenue Service also has major regulatory duties in the areas of employee plans and exempt organizations, and its resources to carry out these responsibilities, already insufficient, are further weakened by the 1986 budget. The recent enactment of TEFRA, DEFRA and REA has made it essential that IRS deliver prompt and responsive guidance to those who must amend their plans to qualify under the complex (and often almost inexplicable) new rules. Failure to qualify carries unacceptable risks, which fall not only upon employers but also upon workers, retirees, and their families. This is not the time to impair IRS' chances of fulfilling its responsibilities. Moreover, reducing audit coverage to .75 percent of employee plans is a long step in the wrong direction. Reduction in IRS' capacity to devise and

enforce reasonable rules relating to exempt organizations is also a step in the wrong direction.

The 1986 IRS budget contains a decrease of 69 average positions allotted to the promulgation of tax rulings. This is quite unfortunate. Too few revenue rulings and procedures are published now (only 269 in 1984 as compared with 636 in 1974) and IRS is much too slow in the issuance of private letter rulings and technical advice memoranda. Even assuming, as the budget contends, that resources can be diverted from rulings on accounting methods and periods, any savings in this area will clearly be insufficient to provide the resources necessary to do an adequate and timely job of publishing revenue rulings and procedures and in issuing the many private rulings and technical advice memoranda that will be necessary to give taxpayers badly needed guidance under complex new laws. The budget document estimates an 11 percent decline since 1984 (approximately 6,000 total) in the number of rulings to be issued and other technical projects to be completed. At a time when major and complex changes in the tax laws have become an almost annual occurrence, and the so-called "compliance gap" is widening, reduction of IRS' capability to respond to taxpayer requests for guidance in obviously unwise.

Chairman PICKLE. Do either one of you care to venture the amount of increase we should have in personnel? You heard the figure this morning, 250, 500, 1,500.

Mr. COHEN. I will venture a remark; my remark would be I would not look at those numbers. I would ask them what the maximum number of personnel that they could recruit, train and properly integrate. That is a different number because, as Mr. Finch said earlier, they are so far from their optimum that you may as well shoot for the maximum. It is probably 4,000 or 5,000 or better. But that is a guess on my part because it depends on their training capability and recruiting capability.

Chairman PICKLE. You are saying, then, that we should ask them what allocation of personnel, how would you make that allocation if you ask for, say, 5,000, 3,000.

Mr. COHEN. Well, no, I would start by asking the Service what is the maximum number of personnel in the areas that have been mentioned earlier by Mr. Finch and former Commissioner Alexander and myself; what is the maximum number they could recruit and train and integrate in a year's time. That number is at least 4,000 or 5,000. It is probably greater than that.

Mr. ALEXANDER. I agree with that approach, Mr. Chairman. We went through this back in 1974. The Internal Revenue, to its surprise, received the additional resources that it had requested in the enforcement area. It had great difficulty in absorbing those resources. So I think you want to get firm figures from them, which I am sure you and your staff will examine very skeptically and carefully and then decide how many average positions to add.

Chairman PICKLE. Both of you are now former commissioners and we have, I guess, four or five other former commissioners floating around somewhere.

Mr. ALEXANDER. It is a growing group, sir.

Chairman PICKLE. They are still alive and very active. We are glad for that. Do you feel that they probably share your feelings about the staffing of the Internal Revenue Service?

Mr. ALEXANDER. Sure.

Mr. COHEN. I am sure they do.

Mr. ALEXANDER. Oh, yes. Again, I think that even the eldest of the group, Mr. T. Coleman Andrews, would probably be of that view, and surely everybody else would.

Chairman PICKLE. You mean, if he would, everybody else would?

Mr. ALEXANDER. Yes, sir.

Chairman PICKLE. We will ask Mr. Andrews.

Mr. ALEXANDER. I have talked with several of the others in the last few months and they have indicated to me the same kind of concern that we have expressed here today.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman. Thank you, gentlemen. It seems to me that Congress is partially to blame for what we are doing. We are creating a huge whirlpool here, and the old IRS is being sucked right down into that whirlpool. We have put some pressure on budgets all the way around. And what we have done is to apply that pressure across the board. It is likely these problems which are springing up around the country are, if not a direct, maybe an indirect result of those budget pressures.

It seems to me that we are not spending enough time with proper staffing, training, and communications at different levels.

Mr. COHEN. Mr. Schulze, I would be the last one to try to defend the Congress, but over the years, as I recall the the IRS budgets, the IRS has got a pretty large percentage of what it has requested. OMB, whether it be Democratic or Republican, has viewed the IRS in a strange way, and has made severe cuts through the Carter administration and through this administration that just are not in keeping with the facts that you are dealing with right now.

Mr. SCHULZE. Maybe these incidences will have a beneficial result. They have made us look with a jaundiced eye at what is going on. That is what I meant when I said we are partially to blame. We really should not just accept those things. We have to look beyond. And if we did not have the incidents in Philadelphia and Austin, perhaps we would not be reviewing the IRS budget in as much depth as we are right now.

Is there anything else that you gentlemen would like to add to what has been said here this morning and this afternoon.

Mr. ALEXANDER. I have nothing further to add, Mr. Schulze, except that I hope that there is time on the part of the Ways and Means Committee to engage in regular oversight hearings. I think they are highly therapeutic to the agency and they are highly necessary to the conduct of this committee's vitally important function to the public.

Mr. COHEN. I would endorse that.

Mr. SCHULZE. I am inclined to agree. Perhaps we probably should get out in the field a little more often and visit the service centers. It would be worthwhile to know what is going on, how they operate, and what are some of the pressures under which people work.

Mr. COHEN. Mr. Schulze, I think it is also helpful to talk to the rank and file IRS people, the people who do the work and to tax return filers and people who deal on a more regular basis with the IRS. You can find problems quicker by talking to those folks than you can by sitting back and waiting for what comes.

Mr. SCHULZE. Thank you, gentlemen.

Chairman PICKLE. We thank both of you gentlemen. I take it that what you are saying is that traditionally the Internal Revenue makes a request for personnel they think they can use to the best efficiency and Treasury normally passes it along with some modifi-

cation and then it hits OMB and then everything stops and it goes in reverse.

Mr. COHEN. That seems to be the case for the last 8 years or more. IRS was not treated that way before except for once in a while, but it has become a very constant pattern lately.

Chairman PICKLE. Well, do you think OMB stops to realize the amount of money we collect from the Internal Revenue Service comes from IRS?

Mr. ALEXANDER. Sure. You make that clear to OMB. And you think that OMB will be sensible, particularly when a new Director comes in; I stayed through several OMB Directors, and I figured that the new Director, unlike the old Director, would, one, understand that very sensible proposition; and, two, act on that understanding.

And I was wrong on No. 2 always or almost always with one exception and occasionally wrong on No. 1. They do not look at it that way, Mr. Chairman. They look through the wrong end of the telescope and focus on Government employment rather than Government receipts. They treat revenue raising agencies as revenue spending agencies, and they argue that they must for some sort of consistency.

Mr. COHEN. I once had a budget director say to me that if I make an exception for you, I will have a line a block long. And I said, that is your function. Ultimately, we both ended up in front of the President and I got my request, but I had to force it that far.

Chairman PICKLE. Well, I am glad you did force it that far. Mr. Alexander, I think you stated it well. They do not understand the problem. I wonder what would happen if we cut OMB about 25 percent.

Mr. ALEXANDER. There are those who would love that, Mr. Chairman.

Chairman PICKLE. Yes. And as important as they are, I think maybe they ought to get a little bit of their own medicine and we may ask somebody to take that into consideration.

I thank both of you gentlemen very much.

Mr. ALEXANDER. Thank you, sir.

Chairman PICKLE. Mr. Robert Tobias and Mr. Gerald Portney are both here now.

We are going to have to recess in 10 minutes, but we will resume just as soon as we can.

[Whereupon, a 10 minute recess was taken.]

Chairman PICKLE. The Chair is pleased to recognize Mr. Robert M. Tobias, who is national president of the National Treasury Employees Union.

And then, we will have at this same panel, Mr. Gerald Portney, principal, representing the Peat, Marwick, Mitchell & Co.

We would be pleased now to hear both of you gentlemen.

STATEMENT OF ROBERT M. TOBIAS, NATIONAL PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION

Mr. TOBIAS. Thank you, very much, Mr. Chairman.

I very much appreciate your interest and concern over the Internal Revenue Service budget, because we believe that the budget submitted by the administration is a travesty and must be rejected.

If approved, it would entail the loss, as we compute it, of over a billion dollars in revenue when the need for revenue is greater than ever. It would lead to further erosion in voluntary compliance when the need to stem the decline in compliance is paramount. And it would gravely weaken the system of tax administration which is already under great strain.

Approval of this budget would plunge IRS to the lowest performance levels in recent years. Returns processing would be cut by 265 people despite the fact, that IRS is coping with 9 million additional returns this year and 5 million more in 1986. And 276 million more information returns this year, and 78 million more next year.

Since 1980, there have been 41 million more primary returns; 500 million more information returns and 9.1 million more refunds paid with 5,200 fewer people in returns processing.

As you might expect the signs of strain are already evident; overtime is up, and many employees are now working 26 hours per week overtime and we believe that the error rate as a result is going to be up significantly this year over last.

We are very pleased that the Commissioner's statistics that he put on this morning show a decline and a continuing decline in the backlog of correspondence and in moving the paper through, but we also want to make it clear that people, are in fact, working a significant amount of overtime to make this happen.

By March 29, IRS had received 1 percent fewer returns than in 1984, but had processed 26 percent fewer. And we are concerned, of course, that if this does not pick up, the Internal Revenue Service is going to owe a significant amount of interest due to people who are not paid by June 1.

The IRS explanation is focused on the major computer change-over at all service centers under the ADP modernization program. Equipment failures have occurred and the usual amount of bugs have been encountered. Equipment has been a contributing factor but it is not the primary factor. Of greater significance of the increase of the returns filed coupled with the budget cuts, this is what has stretched the system thin.

We believe that the responsibilities of the shortfalls of this filing season can be laid directly at the door of OMB. Shortsighted budget policies have drained all reserves out of the returns processing system, eliminating the flexibility to cope with unforeseen developments such as the extra million returns growth that occurred this year. The impact of this shortsighted is bad enough when the Federal Government has to pay interest on taxpayer refunds, but the consequences do not stop there. The increasing complaints of taxpayers about their inability to get through to the IRS, the unanswered correspondence, the unresolved problems are a rude jolt to taxpayer confidence in this system.

In addition to the stress caused by the current work force and the problems to taxpayers in general, the proposed cut in returns processing will result in 650,000 fewer notices to those who under-report their income, with the resulting loss of \$220 million. Thus,

saving 263 positions or \$7,890,000 will cost our Government \$220 million.

I believe that the President is a very bad manager for the tax-paying public. If the President is allowed to have his way, the deficit will increase by \$212.1 million with this action alone. We must repair the present situation and repair it fast.

We urge Congress to take the lead in doing so, by providing adequate resources for returns processing when it considers the fiscal year 1985 supplemental and the fiscal year 1986 budget request. The problems in returns processing are mirrored throughout the Service. The Examination Division is also hard hit and if this fiscal year 1986 budget is approved, the total number of examinations and the percentage of returns audited would fall for the ninth straight year to the lowest in history; 1.2 percent.

There will be 725,000 fewer actual returns audited in 1985, than in 1980. The failure of the audit returns has serious consequences. Fewer audits mean fewer dollars collected. This budget would cost taxpayers \$220 million in direct enforcement revenue from exams, in fiscal year 1986, added to the loss of \$500 million in fiscal year 1985. With the incremental rate of return and examination running at \$20 for every dollar spent, there is no excuse for this loss.

More revenue agents would also help stem the decline in voluntary compliance among taxpayers. Besides the direct enforcement from exams, additional revenue of approximately \$8 billion—our statistics come from the Department of Commerce, Bureau of Economic Analysis—it would be \$8 billion and not \$5 billion for each percent increase in voluntary compliance.

Last year the IRS revised its estimate of the level of voluntary compliance from 90 percent, a figure that they had been using for years, to 81.6 percent, based upon new tax compliance research. The revision is highly significant because it measures the difference between the amount of taxes legally due and the amount paid. The Commissioner of the Internal Revenue Service estimates the loss of tax revenue at \$87 billion in fiscal year 1985, and \$92 billion in 1986.

Projecting this loss over the next 5 years, it will amount to \$600 billion which is equal to 63 percent of the budget deficit projected over the next 5 years. So if we could recapture that money, obviously we would be attacking the deficit.

We believe, and strongly urge the Congress to set a goal of 90 percent voluntary compliance rate. Voluntary compliance only occurs when taxpayers perceive that the IRS can and will identify noncompliers, and will take corrective action. We can win the fight, only if the IRS is provided with the resources to increase the IRS enforcement effort. Today, we are losing that fight.

If this budget is approved the extraordinary backlog of cases and appeals docketed before the Tax Court would rise to astronomical levels. If this budget is approved, 1,300 staff years will be cut from the collection of taxpayer delinquent accounts, with the resulting revenue foregone of \$585 million. With incremental return and collection running at \$19 collected for every dollar spent, and with \$7.6 billion in the inventory of active accounts receivable the Federal Government cannot afford this urgently needed revenue. In fiscal year 1983, after the backlog of past due tax accounts had

gotten out of hand, the administration launched a revenue initiative in which 3,600 more staff years were provided for collection. With this year's budget, all but 400 of those positions are wiped out.

If this budget is approved, some of the 5 million among us who fail to file returns, will have cause to rejoice because there will be a 185,000 fewer delinquent return investigations and 639 million fewer dollars collected, from nonfilers than in fiscal year 1984.

And if this budget is approved, the number of positions in Taxpayers Service will fall 225 below the level of fiscal year 1984, despite a congressional mandate that the fiscal year 1984 level be maintained. As a result, 5 million fewer taxpayers will see walk-in correspondence, or toll-free telephone assistance.

And the numbers that we have recited are not the invention of NTEU. They are spelled out in the budget submission itself, or can be derived directly from the data in that submission, the budget is its own indictment. It is the Office of Management and Budget's job to ensure that the Nation's revenue raising arm, an organization which employs 87,000 people and transacts more business than any corporation anywhere else in the world, is provided with a sensible businesslike plan attuned to the present fiscal crisis.

Instead, OMB has come forward with a plan that would result in foregoing a grant total of \$1.6 billion in revenue that the Federal Government urgently needs. The revenue loss is summarized in table 1 attached to our statement.

According to our calculations, Mr. Chairman, and these, here again, are based on the budget submission, it will require \$234 million and 2,900 average positions just to restore the IRS program to the level provided by the fiscal year 1985 continuing resolution, plus normal workload growth.

We consider this amount to be a bedrock minimum requirement for a realistic program in fiscal year 1986. Of the \$234 million required, \$100 million is to eliminate the 5 percent paycut proposed for Federal employees. \$87 million to offset program reductions; \$33 million to restore 800 positions cut in fiscal year 1985 through pay absorption and \$13 million to offset so-called productivity savings.

We also consider it indispensable that the amount required to offset the paycut for Federal employees be restored to each agency's budget this year, rather than through a pay supplemental next year.

The reason is that by requiring absorption of all or part of pay requirement, OMB can hold each agency's budget hostage next year.

NTEU's alternative budget to restore IRS programs to the level of fiscal year 1985 continuing resolution plus normal workload growth is contained in table 2, attached to our statement. The additional revenue that would be generated by adopting this budget, \$1.1 billion in fiscal year 1986, and \$5.5 billion in over the next 5 years, is shown in table 3.

You will note that this budget provides only a bare minimum augmentation of staff in various functions. We believe that such a current Service budget is inappropriate to the challenges that face our Nation at this critical juncture. Therefore, we would go fur-

ther. We recommend advancing the date of the administration's proposed revenue initiative from fiscal year 1987, when it is now scheduled to begin, to fiscal year 1986. As you know, the budget contains a proposal to add 2,500 additional examination positions during the period of fiscal year 1987 to 1989 to collect \$4.6 billion in additional revenue.

Surely there is little reason to deny implementation of this proposal. The administration supports the plan and acknowledged that it is needed. The Congressional Budget Office in its list of deficit reduction options for fiscal year 1986, has proposed an even larger plan that would add 5,000 average positions.

We believe that Congress should seize the opportunity presented by the administration and advance the revenue initiative to fiscal year 1986. Doing so would add 2,500 average positions at a cost of \$87.5 million to NTEU's budget proposal bringing our proposal to \$321 million and 5,400 positions to be added to the fiscal year 1986 budget request.

Our total budget recommendation for fiscal year 1986, would then be \$3.8 billion and 92,000 average positions. Table 4, attached to our statement, shows NTEU's recommendation for restoring the fiscal year 1986 budget to the fiscal year 1985 level, plus normal workload growth and advancing the administration's revenue initiative to fiscal year 1986.

This program would yield net revenue of \$2.4 billion in 1986, and \$9.3 billion over the next 5 years. Those are significant numbers, Mr. Chairman.

What is the alternative to accepting our budget? The alternative is not simply a loss of tax revenue, but continuation of the decline in voluntary compliance. This is serious business. Once people become convinced that it is all right to cheat because others do so—the Yankelovich survey found that one-third of all taxpayers believe this—public attitudes may become irreversible, and this would spell the end of our tax system as we know it.

The longer that we wait to raise the level of compliance the greater the danger that we run.

The outlook is grim if the IRS does not achieve a prudent and realistic budget for the 1986 fiscal year. We are prepared to work with the Congress in fashioning and enacting such a budget.

I would like to also call your attention to the impact on IRS of the administration's proposed pay supplemental for fiscal year 1985. Of the \$66 million required for this year's pay increase, OMB would allow IRS to request only \$33 million. The remaining \$33 million is to be taken out as an 800 position staff reduction from the levels established by Congress in the fiscal year 1985 continuing resolution.

Therefore, if this \$33 million, if the \$66 million is not restored, we will lose 800 positions this year, before we even get to fiscal year 1986. The loss of these positions is not only unwarranted in view of the challenges facing the Service, but will entail a revenue loss of at least \$400 million.

We trust that Congress will restore this \$33 million when it considers the fiscal year 1985 pay supplemental. And we also believe that Mr. Chairman, that there is going to be another supplemental that will come forward to cover the immense amount of overtime

which is now occurring in these Service Centers; 26 hours per week for large numbers of people is going to amount to a lot of money.

What we have been told is that it would amount to \$45 million and some 1,800 FTE positions.

I would also like to bring to your attention, two matters that had been the subject of discussion between IRS and NTEU.

The IRS improved automation capabilities make possible the statistical measurement of performance against program objectives. We certainly have no objection to using statistics to measure the performance of an organizational unit, but we strongly object to applying the system to individuals. The reason is that it is unwise to have employees subject to performance measures that do not reflect differences in individual situations and that can readily translate into quotas and production pressure. Experience shows that this would have a negative effect on the morale and retention of employees, and the quality of work and on taxpayers.

The second matter relates to protecting IRS employees from potentially dangerous taxpayers. Assaults and threats directed against IRS employees have increased from 531 in 1983, to 789 in 1984; a 50-percent increase. There has been a sharp rise in such incidents since 1981, and their severity has also increased.

A revenue officer in Buffalo was shot and killed while making a field call. Another in Cleveland suffered multiple gunshot wounds at the hands of a taxpayer during a meeting at an IRS office. In Washington, DC, a taxpayer was convicted of attempting to murder a revenue agent. The Service is responding to this serious situation, but problems remain.

A way must be found to protect IRS employees from potentially dangerous taxpayers who enter IRS field offices to meet with Service representatives.

The Department of Justice must also vigorously prosecute individuals involved in assault, threats and harrassment of IRS employees. We need Congress' assistance in this matter, and we are asking for your help.

I would like to conclude by noting that the Yankelovich Public Opinion Survey, I mentioned earlier, found that a substantial majority of Americans, about 60 percent believe IRS to be trustworthy, accurate and staffed by knowledgeable people.

IRS employees can take some satisfaction in this result, knowing that their job is a difficult one and there is a great deal riding on how they perform it. Our voluntary tax compliance system is a great institution and we are not unmindful of our responsibility for preserving it, but we need more resources, not less.

We ask Congress to provide us with the resources that we need to do the job that we can and must do. And we also ask Congress to attack the deficit by collecting the tax due, \$87 billion this year; \$92 billion next year. Allocating more resources will begin to solve the problem, the President's approach must be rejected.

Thank you, very much, Mr. Chairman.

Chairman PICKLE. We will put your full statement into the record.

[The prepared statement follows:]

STATEMENT OF ROBERT M. TOBIAS, NATIONAL PRESIDENT, NATIONAL
TREASURY EMPLOYEES UNION

Mr. Chairman and Members of the Subcommittee: I am Robert M. Tobias, National President of the National Treasury Employees Union. Our union is the exclusive representative of over 120,000 Federal workers, including virtually all employees of the Internal Revenue Service. I am accompanied today by Paul Newton, NTEU Director of Legislation, and Paul Suplizio, legislative consultant.

On behalf of the thousands of dedicated men and women who collect the revenue of the Federal government, I appreciate this opportunity to express our union's views on the Administration's budget request for IRS for Fiscal Year 1986.

The budget submitted by the Administration is a travesty and should be rejected. If approved, it would entail the loss of over a billion dollars in revenue, when the need for revenue is greater than ever; it would lead to further erosion in voluntary compliance, when the need to stem the decline in compliance is paramount; and it would gravely weaken a system of tax administration which is already under great strain.

Approval of this budget would plunge IRS to the lowest performance levels in recent years. Returns Processing will be cut by 3 percent, despite the fact that IRS is coping with 9 million additional returns this year and there will be 5 million more in FY 1986. Signs of strain in the system are already evident, and further cuts would be most unwise. Ironically, the proposed budget will result in 650,000 fewer notices to those who underreport their income, with a resulting revenue loss of \$220 million -- more than enough needed to provide for the workload growth.

As is well-known from press accounts, this filing season is not going well for IRS. By March 29, IRS had received 1 percent fewer returns than in 1984, but had processed 26 percent fewer. The number of refunds issued by the end of March was down 29 percent from a year earlier. The lag between the time a return is received and the refund mailed has increased to eight weeks. There are only seven weeks between April 15 and June 1st, after which IRS must pay interest on refunds. If the rate of processing does not improve in the next few weeks, it will end up costing the government money.

IRS' explanation has focused on the major computer changeover at all Service Centers under the ADP modernization program. Equipment failures have occurred, and the usual amount of bugs have been encountered. Equipment has been a contributing factor, but it is not the primary factor.

Of greater significance is the increase of 9 million returns, coupled with budget cuts in Returns Processing to below levels authorized by Congress. This is what has stretched the system thin.

In the FY 1984 Continuing Resolution, Congress authorized 24,297 average positions for Returns Processing. When OMB got finished with this allowance -- after requiring IRS to absorb substantial pay and other cost increases -- the actual number of positions realized was 21,743, or 2,500 positions fewer than the Congressional Appropriation.

This is the situation that existed in October, 1984 -- just a few months before the onset of the 1985 filing season. IRS was short-changed by 4,200 average positions for returns processing -- the 2,500 mentioned earlier plus 1,700 additional positions needed during the 1985 filing season.

We believe that the responsibility for the shortfalls of this filing season can be laid directly at the door of OMB. Its short-sighted budget policies have drained all reserves out of the returns processing system, eliminating the flexibility needed to cope with unforeseen developments such as the extra million in returns growth that occurred this year.

The impact of this short-sightedness is bad enough when the Federal government has to pay interest on taxpayer refunds. But the consequences do not stop there. The increasing complaints of taxpayers about their inability to get through to IRS, the unanswered correspondence and unresolved problems, are a rude jolt to taxpayer confidence in the system.

We must repair the present situation, and repair it fast. Congress should take the lead in doing so, by providing adequate resources for Returns Processing when it considers the FY 1985 Supplemental and FY 1986 budget requests.

If this budget is approved, the total number of examinations would fall for the ninth straight year, and audit coverage would be the lowest in history, 1.2 percent. There would be a loss of \$220 million in direct enforcement revenue from exams in FY 1986, coming on top of a loss of \$500 million in FY 1985. With the incremental rate of return in Examination now running at \$20 per every dollar spent, there is no excuse for this loss.

More Revenue Agents would also help stem the decline in voluntary compliance among taxpayers. Besides the direct enforcement revenue from exams, additional revenue of approximately \$8 billion accrues for each one percent increase in the level of voluntary compliance. By helping

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to raise the level of voluntary compliance, additional audits cause a large amount of revenue to flow to the Treasury.

Last year, IRS revised its estimate of the level of voluntary compliance from 90 percent -- a figure it had been using for years -- to 80 percent, based upon new tax compliance research. This revision is highly significant; it shows there is plenty of room for improvement in the level of compliance. We believe Congress should set as a goal to get this rate back up to 90 percent, by providing the resources needed to increase IRS enforcement programs until this goal is met.

If this budget is approved, the extraordinary backlog of cases in Appeals and docketed before the Tax Court, would rise to astronomical levels -- from 71,000 to 84,000 cases in Appeals, and from 67,000 to 100,000 cases docketed for trial. More than 60 percent of the cases in Appeals, and a third of the docketed cases involve abusive tax shelters, where prompt resolution is essential for fairness to the taxpayer and to curb this type of abuse.

With over 300,000 tax shelter cases still in Examination, the appellate system is overloaded and IRS is now auditing fewer partnership returns. Recently, it dropped its audit coverage of these returns substantially from 2.4 to 1.6 percent. If the logjam in Appeals is not resolved, the promising attack on abusive tax shelters will be jeopardized. IRS should be given the resources to clean up this backlog.

If this budget is approved, 1,300 staff-years will be cut from the collection of taxpayer delinquent accounts, with a resulting revenue foregone of \$585 million. With incremental return in Collection running at 19 dollars

collected for every dollar spent, and with \$7.6 billion in the inventory of active accounts receivable, the Federal government cannot afford to forego this urgently needed revenue.

In FY 1983, after the backlog of past-due tax accounts had gotten out of hand, the Administration launched a revenue initiative in which 3,600 more staff-years were provided for Collection. With this year's budget, all but 400 of those positions are wiped out.

If this budget is approved, some of the 5 million among us who fail to file tax returns will have cause to rejoice, because there will be 185,000 fewer delinquent return investigations and \$639 million fewer dollars collected from non-filers than in FY 1984.

If this budget is approved, the number of positions in Taxpayer Service will fall 225 below the level of FY 1984, despite a Congressional mandate that the FY 1984 level be maintained. As a result, 5 million fewer taxpayers will receive walk-in, correspondence, or toll-free telephone assistance.

The numbers we have recited are not the invention of NTEU. They are spelled out in the budget submission itself, or can be derived directly from the data in that submission. This budget is its own indictment.

It is the Office of Management and Budget's job to ensure that the nation's revenue-raising arm -- an organization which employs 96,000 people and transacts more business than any corporation anywhere else in the world -- is provided with a sensible, business-like plan attuned to the present fiscal crisis. Instead, OMB has come forward with a plan that would result in foregoing a grand total of

\$1.6 billion in revenue that the Federal government urgently needs. The revenue loss is summarized in Table 1, attached to our statement.

According to our calculations Mr. Chairman -- and these are again based on the budget submission -- it will require \$234 million and 2,900 average positions just to restore the IRS program to the level provided by the FY 1985 Continuing Resolution, plus normal workload growth. We consider this amount to be a bedrock minimum requirement for a realistic program in FY 1986. Of the \$234 million required, \$100 million is to eliminate the 5 percent pay cut proposed for Federal employees, \$87 million is to offset program reductions, \$33 million is to restore 800 positions cut in FY 1985 through pay absorption, and \$ 3 million is to offset so-called productivity savings.

We are not opposed to productivity savings, as NTEU has been in the forefront of efforts to assure a modernized, efficient Service. But we all know that so-called productivity savings are simply OMB's way of disguising program cuts, and we have seen what staff reductions from phony productivity savings have done to the capabilities of our IRS Service Centers in recent years. We believe that, while productivity savings are inevitable and desirable, any such savings should be re-directed to other programs and not used to cut skilled personnel who are essential to an effective Service.

We also consider it indispensable that the amount required to offset the 5 percent pay cut for Federal employees be restored to each agency's budget this year, rather than through a pay supplemental next year. The reason is that, by requiring absorption of all or part of pay requirement OMB can hold each agency's budget hostage next year. To repeat, funds to restore the 5 percent pay

cut should be put back into the budget this year.

NTEU's alternative budget to restore IRS programs to the level of the FY 1985 Continuing Resolution, plus normal workload growth, is contained in Table 2, attached to our statement. The additional revenue that would be generated by adopting this budget -- \$1.1 billion in FY 86 and \$5.5 billion over the next five years -- is shown in Table 3. You will note that this budget provides only a bare minimum augmentation of staff in various functions: 1,103 positions for Returns Processing, 513 positions for Examination and Appeals, 1,244 positions for Investigation, Collection, and Taxpayer Service.

We believe such a "current service" budget is inappropriate to the challenges facing the nation at this critical juncture. Therefore, we would go further. We recommend advancing the date of the Administration's proposed revenue initiative from FY 1987, when it is now scheduled to begin, to FY 1986.

As you know, the budget contains a proposal to add 2,500 additional Examination positions during the period FY 1987-89, to collect \$4.6 billion in additional revenue. Surely, there is little reason to delay implementation of this proposal. The Administration supports the plan, and acknowledges that it is needed. The Congressional Budget Office, in its list of deficit reduction options for FY 1986, has proposed an even larger plan that would add 5,000 average positions for examinations over a five-year period beginning in FY 1986.

We believe Congress should seize the opportunity presented by the Administration and advance the revenue initiative to FY 1986. Doing so would add 2,500 average positions at a cost of \$87.5 million to NTEU's budget

proposal, bringing our proposal to \$321 million and 5,400 positions to be added to the FY 1986 budget request.

Our total budget recommendation for FY 1986 would then be \$3.8 billion and 92,000 average positions. We would like to note that IRS requests to OMB in recent years have been for around 94,000 average positions. This is management's own assessment of its resource needs to deal with increased returns processing workload, implementation of new legislative requirements, systems modernization, the tax gap and other compliance programs. Even with the additions we have made, we are still 2,000 positions below the level Mr. Egger has been requesting of OMB.

Table 4, attached to our statement, shows NTEU's recommendation for restoring the FY 1986 budget to the FY 1985 level plus normal workload growth, and advancing the Administration's revenue initiative to FY 1986. Table 5 shows the revenue that would accrue from the NTEU program. All told, the program would yield net revenue of \$2.4 billion in FY 1986, and \$9.3 billion over the next five years.

What is the alternative to accepting our budget? The alternative is not simply a loss of tax revenue, but continuation of the decline in voluntary compliance. This is serious business. Once people become convinced that it's all right to cheat because others do so -- the Yankelovich survey found that one-third of all taxpayers believe this -- public attitudes may become irreversible and this would spell the end of our tax system as we know it. The longer we wait to raise the level of compliance, the greater the danger we run.

Opportunity lies in the fact that, by acting now to raise compliance, large revenues can be claimed that are

legally due the Federal government. Last year, the Commerce Department's Bureau of Economic Analysis reviewed IRS's major study of the tax gap -- the difference between taxes voluntarily paid and the amount legally due -- and concluded that unreported income in this country stood at 8 percent of GNP, and was growing at a 14 percent annual rate. This would cause a doubling of unreported income about every five years.

As the IRS's tax gap estimates stop in 1981, we have projected those estimates forward to 1990. Our projections show that the tax gap is now \$120 billion a year and rising. As a nation, we stand to lose more than \$600 billion dollars in tax revenue over the next five years.

It is true that Congress has given IRS new tools for dealing with compliance problems, and many believe that tax reform would have a favorable impact on voluntary compliance. But to utilize these tools effectively IRS must be given adequate resources, and until tax reform becomes a reality we simply do not know what the impact on compliance will be. We do know that today abusive tax shelters are sheltering as much as \$35 billion in income each year, that 2 million taxpayers are now claiming partnership losses on their returns, and that their number is growing.

So the outlook is grim if IRS does not achieve a prudent and realistic budget this year. We are prepared to work with the Congress in fashioning and enacting such a budget.

I would also like to call your attention to the impact on IRS of the Administration's proposed pay supplemental for FY 1985. Of the \$66 million required for this year's pay increase, OMB would allow IRS to request only \$33 million. The remaining \$33 million is to be taken as an 800

position staff reduction from the levels established by Congress in the FY 1985 Continuing Resolution. The loss of these positions is not only unwarranted in view of the challenges facing the Service, but will entail a revenue loss of at least \$400 million. We trust that Congress will restore this \$33 million when it considers the FY 1985 pay supplemental.

I would now like to bring to your attention two matters that have been the subject of discussion between IRS and NTEU. IRS' improved automation capabilities make possible the statistical measurement of performance against program objectives. We have no objection to using statistics to measure the performance of an organizational unit, but we strongly object to applying this system to individuals. The reason is that it is unwise to have employees subject to performance measures that do not reflect differences in individual situations, and that can readily translate into quotas and production pressure. Experience shows that this would have a negative effect on the morale and retention of employees, on the quality of work, and on taxpayers.

The second matter relates to protecting IRS employees from potentially dangerous taxpayers. Assaults and threats directed against IRS employees increased from 531 in 1983 to 789 in 1984 -- a 50 percent increase. There has been a sharp rise in such incidents since 1981, and their severity has also increased. A Revenue Officer in Buffalo was shot and killed while making a field call; another in Cleveland suffered multiple gunshot wounds at the hands of a taxpayer during a meeting at an IRS office; in Washington, D.C. a taxpayer was convicted of attempting to murder a Revenue Agent. The Service is responding to this serious situation, but problems remain. A way must be found to protect IRS employees from potentially dangerous taxpayers who enter IRS field offices to meet with a Service representative. The

Department of Justice must also move vigorously to prosecute individuals involved in assault, threat, and harassment of IRS employees. We need Congress's assistance in this matter, and we are asking for your help.

I would like to conclude by noting that the Yankelovich public opinion survey I mentioned earlier found that a substantial majority of Americans -- about 60 percent -- believe IRS to be trustworthy, accurate, and staffed by knowledgeable people. IRS employees can take some satisfaction in this result, knowing that their job is a difficult one and there is a great deal riding on how they perform it. Our voluntary tax compliance system is a great institution and we are not unmindful of our responsibility for preserving it.

The remainder of our statement will discuss the basis for our budgetary recommendations, and the forces shaping workload, resources, and programs in major functional areas of IRS.

Compliance and the Tax Gap

When it comes to providing resources for tax compliance, Congress is in the enviable position of being able to kill two birds with one stone. Additional compliance resources will not only raise revenues directly, but will improve the level of voluntary compliance among taxpayers generally, thereby yielding even more revenue to the Treasury.

This is no unproven theory, as the revenue initiative of FY 1983 conclusively demonstrates. You will recall that two years ago Congress authorized 5,000 additional positions, and made changes in the tax code to improve taxpayer compliance and collection of past-due accounts.

The revenue from this initiative is now being realized, and is duly recorded in this year's budget. Here is the estimate of receipts that appears on page 4-7 of the budget: Fiscal Year 1983, \$4.7 billion; Fiscal Year 1984, \$12.7 billion; Fiscal Year 1985, \$10.6 billion; Fiscal Year 1986, \$11.1 billion; Fiscal Year 1987, \$10.5 billion, Fiscal Year 1988, \$9.8 billion. Over the six-year period, 1983-1988, a grand total of \$60 billion will have been raised by this revenue initiative at a cost of \$900 million over the same six-year period for those 5,000 positions.

These results show the tremendous revenue potential of our tax system when relatively small increments of resources are added to the substantial plant in existence. Where else in the entire government would an investment of \$900 million yield revenues of \$60 billion? If Congress had been unwilling to act two years ago, the bulk of these revenues would have been lost. But Congress took determined action, and the wisdom of its decision is unquestionable.

Failure to act to stem the deterioration of tax compliance that has occurred over the past decade would not only lead to large revenues foregone from taxpayers unwilling to pay their fair share, but would lead to further erosion of tax receipts through a "ripple effect" upon honest taxpayers of the perception that all are not paying their fair share. It is the shift of attitudes among taxpayers generally, prompted by recurrent reports of tax shelter abuses, underreporters, and non-filers who play "audit roulette" and get away with it, that poses the greatest threat to our voluntary compliance system.

Mr. William J. Anderson of the General Accounting Office summed up this problem when he told a House Government Operations subcommittee:

"There is a trend toward contempt and abuse of the system which seriously undermines the basic concept of voluntary compliance on which the system depends. Extensive evidence is available to show that noncompliance among both corporate and individual taxpayers is a serious problem and is getting worse."

Last summer, the Internal Revenue Service completed five years of exhaustive research into the state of taxpayer compliance and noncompliance. Its findings, which are presented in Tables 7, 8, and 9 appended to our testimony, are a report card on the health of our voluntary compliance system.

The IRS study found that the tax gap -- the difference between taxes legally owed and voluntarily paid -- on corporate and individual income was \$81.5 billion in 1981. By far the largest component of the tax gap, \$52 billion, is attributed to unreported income on returns of individuals. Overstated business expenses and personal deductions accounted for another \$13 billion lost on individual returns, while the corporation tax gap was \$6.2 billion.

The study estimated the unreported income of individuals in 1981 to be \$250 billion, of which \$95 billion was wages and salaries, \$58 billion was nonfarm proprietor income and small business corporation income, \$20 billion was interest income, \$18 billion was capital gains income, and \$17 billion was "informal supplier income". Informal suppliers are those engaged in "off-the-books" transactions of the kind associated with the underground economy.

For each component of personal income, the IRS computed "voluntary reporting percentages". This is the percentage of income of both filers and nonfilers that was voluntarily

reported. The study found that 94 percent of wages and salaries, 84 percent of dividends, 86 percent of interest, 59 percent of capital gains, 79 percent of nonfarm proprietor and small business corporation income, and 21 percent of informal supplier income was voluntarily reported to IRS in 1981. Overall, 89.3 percent of taxable income was voluntarily reported, compared to 91.2 percent in 1973. There has been a steady decline of about .2 percent a year in voluntary reporting since 1973.

Even more significant is the fact that IRS has had to revise its overall estimate of tax compliance by individuals from a 90 percent compliance level before the study was made to 80 percent thereafter. IRS found the state of individual taxpayer compliance to be much lower than the results it had been getting earlier from its Taxpayer Compliance Measurement Program.

The compliance level is the percentage of taxes voluntarily paid to taxes legally due. While the voluntary reporting percentage shows the amount of income voluntarily reported, there are additional tax losses due to overstated expenses and deductions, which brings the overall compliance level down to 80 percent.

IRS announced this major drop of ten percentage points in individual tax compliance without explanation. Testifying before the Senate Finance Committee on June 23, 1983, the Acting Commissioner of Internal Revenue stated:

"Despite the magnitude of the problem, I can't emphasize too strongly that most taxpayers are conscientious, and that the tax system is basically sound and reliable. The tax reported voluntarily -- that is, without any enforcement effort -- is approximately 80 percent of what is owed. We should not

overlook, however, the fact that this voluntary compliance results largely from a good set of tax administration rules based on withholding and information reporting, and a tradition of effective and fair tax administration."

So the Administration has chosen to downplay a most startling and revealing fact, namely, that individual tax compliance has fallen from the 90-percent to the 80-percent level. We believe that a more realistic assessment is called for in the face of this new evidence. We urge Congress to take the lead in examining the full implications of these findings, which show the tax system to be in a more debilitated condition than was heretofore thought.

NTEU has used the data from the IRS study to project the tax gap to 1990. This projection is shown in Table 6. Our projection assumes continued deterioration in voluntary reporting at the rate of .2 percent a year through 1985, and holding constant thereafter. Our results show that the tax gap will increase from \$81.5 billion in 1981 to \$170 billion in 1990. The cumulative tax loss for tax years 1985-1989, which correspond roughly to Fiscal Years 1986-1990, would be \$746 billion over those five years. This is 63 percent of the \$1,181 billion current services deficit projected in the budget for those years.

Recovery of these enormous revenue losses is not only an urgent national need, it is essential to stem the downward trend of noncompliance and insure that everyone in society pays his fair share of the tax burden. Reversing this downward trend is essential to the survival of our voluntary compliance system.

Prompt action is required to achieve these goals. Congress should:

- o Establish a 90 percent overall compliance level as an objective. IRS should be required to report to the Congress annually its progress toward achieving this objective.
- o Provide IRS with the resources needed to stem the decline in voluntary compliance among taxpayers generally, and prevent the tax gap from expanding further. This would require incremental increases in audit coverage with a target of 2.0 percent, an increase in the number of Service Center contacts with taxpayers, and continued strong commitment to Taxpayer Service.
- o Provide IRS with sufficient resources to deal with specific compliance problems, including abusive tax shelters, income underreporting, delinquent accounts receivable, and offshore tax havens.

In its recent report on deficit-reduction options for FY 1986, the Congressional Budget Office has estimated that audit coverage could be raised from 1.4 percent in FY 1985 to 2.3 percent in FY 1990 for a total cost of \$1.6 billion. According to CBO, this would yield net additional revenue of \$10.8 billion over the five-year period. CBO's calculations support the view that raising audit coverage would improve taxpayer compliance and generate substantial additional revenues.

The results of the revenue initiative of FY 1983 demonstrate the revenue-generating potential of increased audit coverage. One thousand additional staff-years were provided for the Examination Division under the initiative. The results, according to figures presented in this year's budget, are \$807 million in FY 1983 and \$1.0 billion in FY 1984. As the cost of the 1,000 positions was \$70

million, this means they produced an incremental yield of \$25 for each dollar invested. At this rate of return, how can the Federal government afford not to invest in improved compliance?

Some view increased IRS compliance efforts as an unwarranted intrusion, instead of a means of insuring that all taxpayers pay their fair share. During the 1960's, five percent of tax returns were audited and the public did not consider this too great an intrusion. As recently as 1976, the audit coverage was 2.6 percent. Inadequate compliance resources have reduced this to 1.3 percent today, while at the same time the tax gap has more than tripled from \$39 to \$120 billion. Too many taxpayers abusing the system are gambling that they won't be caught. The perception that many are cheating and getting away with it contributes to a general decline in voluntary compliance. The root cause of this trend is not that IRS is too intrusive, but that it is not intrusive enough.

The General Accounting Office has made this point succinctly:

"It is important to keep in mind that IRS' various compliance activities do no more than require citizens to pay those taxes that were properly due in the first place, and that in fact were so paid by most of their number. Effective compliance should not be viewed as representing a special burden to the public at large; rather it is aimed at insuring that all share their fair burden."

A large and growing gap between IRS workload and resources has emerged over the past decade. The deterioration in compliance we are witnessing stems in large measure from the generally inadequate level of resources

provided. The total of all returns filed (primary, supplemental, and information documents) increased 63 percent between 1972 and 1983. Individual tax refunds scheduled grew 46 percent during the same period. In contrast, total IRS obligations in constant 1972 dollars increased only 17 percent, and total staff-years increased 23 percent.

As more people enter the labor force, the number of taxpayers increases and so do the number of tax returns filed. Without changing the tax law, this basic workload is uncontrollable. A growing number of returns must be processed, refunds scheduled, examinations conducted, and accounts collected. The increasing complexity of our tax laws adds to the basic workload by making the processing of returns more time-consuming.

At the same time, compliance problems posed by tax protestors, tax shelters, and the underground economy have risen in magnitude. New missions, such as implementing the Windfall Profit Tax Act, and the Interest and Dividends Tax Compliance Act, have proliferated. Billions of dollars in past-due taxes have accumulated. Offshore tax havens have emerged as a major new challenged.

The disparity between workload and resources that has been accumulating for a dozen of years has plunged the tax administration system to the lowest levels of performance in history. Audit coverage in FY 1985 will be the lowest ever, 1.3 percent. This marks the fifth straight year in which coverage has remained below 2 percent. Because of fewer examinations, additional tax assessments will fall from \$14.6 billion in FY 1984 to \$14.1 billion in FY 1985, a loss of \$.5 billion dollars. The Appeals backlog will rise by an additional seven million cases in FY 1985, and another 6 million in FY 1986. Delinquent returns investigations will

be 176,000 fewer this year than in FY 1984 resulting in revenue loss of about \$610 million. The number of taxpayer delinquent accounts is increasing at about the same rate as dispositions, causing the inventory of delinquent accounts to remain essentially unchanged at a time when top priority should be given to reducing the backlog in the collection program. The amount of revenue in the active inventory remains at a historically high level, \$7.6 billion in FY 1985.

The alternative budget we have presented is only the first step in remedying the cumulative resource deficiencies of the past dozen years. The present situation cannot be reversed overnight. It took us several years to get into our present predicament, and it will require several years of consistent resource augmentation to achieve the levels of tax compliance we seek.

The overall cuts made by OMB, from 89,000 average positions in the FY 1984 Continuing Resolution to 88,000 in FY 1985 and 86,000 in FY 1986 do not make sense in light of the steady growth of workload and deterioration in taxpayer compliance. The General Accounting Office has taken issue with OMB on this score. With respect to an earlier proposed cutback it stated:

"This ratcheting of staffing levels makes it extremely difficult to develop well-founded plans for acquiring, training, and focusing human resources on the multi-faceted task of administering the tax system. A larger and more consistent level of resources to keep pace with growing demand on the tax system appears in order."

In the remainder of our testimony, we would like to consider the dimensions of the workload-resource imbalance

for Examination and Appeals, Collection, Returns Processing, and Taxpayer Service. We will consider the performance levels in these functions under the Administration's budget request and our own alternative budget for Fiscal Year 1986.

Examination and Appeals

Examination and Appeals is the backbone of IRS' efforts to achieve a high degree of voluntary compliance with the tax laws. The willingness of taxpayers to file tax returns, correctly assess their liability, and make timely payment is influenced by their perception that these actions will be required if not done voluntarily. Voluntary compliance is dependent to a significant degree on public confidence that IRS is able to identify noncompliance and will take corrective action.

Publicity given to the underground economy, abusive tax shelters, and other forms of noncompliance can have an adverse effect upon compliance among the general public. A perception is fostered that many are not paying their fair share of taxes. This can create a "ripple effect" among normally honest taxpayers, causing them to cheat because what they have read, seen or heard has convinced them that "everyone" is doing it.

A public opinion survey conducted by Yankelovich, Skelly and White last year bears this out, for a majority believe that the public is cheating on their taxes, and that tax cheating is becoming more prevalent. One in five admitted to cheating on their own returns, while one in three took positions that strongly condoned cheating. The perception that others are cheating and getting away with it can seriously undermine our system of voluntary compliance.

Given the overwhelming evidence of sharply declining

compliance and its ruinous impact on the tax system, to complacently accept the 1.2 percent examination rate recommended by the Administration for FY 1986 would be a blueprint for disaster. It would assure continuation of the declining trend in voluntary compliance at the critical moment when we should be moving decisively to prevent any further ripple effect among honest taxpayers.

We have already noted that the revenue initiative of FY 1983 is yielding revenue at the rate of \$25 return for each dollar invested in Examination. Recovering these revenues is essential not only to reducing the Federal government's deficit but to insuring that all taxpayers pay their fair share.

Examination must also deal with special compliance problems of major dimensions, including underreporting, abusive tax shelters, and offshore tax havens.

In the area of underreporting, IRS has chosen to focus on the relatively low compliance levels of sole proprietorships and small business corporations. The most recent study of the tax gap concluded that \$58.4 billion in income from these two sources was not reported in 1981. Altogether 21.3 percent of sole proprietor and small business corporation income went unreported.

This problem was also raised by earlier evidence from the Taxpayer Compliance Measurement Program, which found that compliance among small business taxpayers with adjusted gross incomes under \$10,000 fell from 79.2 percent in 1965 to 43.2 percent in 1976. This means that these taxpayers paid only 43 percent of the taxes they owed in 1976.

The GAO subsequently analyzed TCMP data for small corporations, those with assets of up to \$1 million, between

1969 and 1978. Compliance for this group dropped almost ten percentage points from 83.1 to 73.3 percent during those years.

In order to attack this problem successfully, IRS will need to refine its tools for identifying tax returns with significant amounts of unreported income. More thorough audits will have to be conducted. IRS states that it is now emphasizing quality audits over quantity. It notes that, as the tax laws have grown more complex, audits are dealing with more complex issues and are taking more time to complete. They are also yielding more revenue.

Examination is also at the forefront of IRS' efforts to deal with abusive tax shelters. These shelters generate, through inflated asset valuations and other devices, deductions and credits far in excess of funds placed at risk. Tax shelter schemes, both legitimate and abusive, are widely publicized and highly visible. As their use increases, public confidence in our tax system falls.

IRS is making some inroads against abusive tax shelters, but not nearly enough progress as necessary. At the end of FY 1982, it had 285,000 tax shelter cases under examination and recovered \$1 billion out of an estimated \$6 billion in questionable deductions. At the end of Fiscal Year 1983, the backlog of cases increased to 334,549 and IRS recovered \$1.8 billion out of approximately \$7 billion in questionable deductions. In FY 1984, the backlog stood at 331,395 and \$2.2 billion was recovered on 114,323 cases closed -- an average of \$19,240 per return.

IRS estimates that it loses \$3.6 billion annually due to illegal tax shelters. Over the four-year period FY '81 to FY '84, the Annual Reports of the Commissioner showed that IRS recovered \$5.6 billion of the \$14.4 billion

potential loss. In other words, the net loss to the Treasury from tax shelters alone for this period was nearly \$9 billion.

It is little wonder that the sale of tax shelters is growing by leaps and bounds. The use of shelters is now spreading from upper-bracket to middle-bracket taxpayers. In a recent study, the Joint Committee on Taxation states:

"A major concern is that the highly visible marketing of tax shelters, and the accompanying belief that the Internal Revenue Service cannot deal with them, may erode taxpayers' confidence in the fairness and effectiveness of the tax system....The widespread use of tax shelters deprives the system of its claim to fairness and retards the administrative and judicial processes to the point that penalties seem neither certain nor costly....The growth of shelters feeds on itself: As the tax base is eroded, rates must be raised to maintain revenues which in turn increases the demand for tax shelters."

Because most tax shelters are structured as limited partnerships, where income or loss is flowed through and taxed at the partner level, IRS significantly increased its audit coverage of partnership returns in 1983 by 16,000, and raised the audit coverage of those returns from 1.63 to 2.41 percent in a single year. (Audit coverage for individual, partnership, and corporation returns is shown in Table 10.) This additional emphasis has raised assessments, but considering the large backlog of unresolved cases and the fact that audit coverage was again reduced in 1984, it is evident that current resources are totally inadequate to deal with this major problem.

The increased emphasis on partnership returns was accompanied by a sharp drop in the number of corporate returns audited -- 22,000 fewer in 1983 than in 1982. Under the Reagan Administration, audit coverage of corporation returns which stood at 8 percent in 1978, plunged to 2.66 percent last year. We have previously called the attention of Congress to the decline, which can only be stemmed by providing IRS with the necessary resources and directing that a minimum audit coverage for corporations be maintained. Failure to stem the sharp decline in corporate audits will only fuel the perception that the tax policies of this Administration are weighted toward "corporate America" at the expense of the individual taxpayer.

Offshore tax havens are a newly-emerging compliance problem that also requires significantly strengthened examination resources. The practice of sheltering income from U.S. taxes by transferring funds to off-shore tax haven jurisdictions is becoming increasingly widespread. The Commissioner of Internal Revenue told Congress last year:

"It is clear that billions of dollars in taxes are being lost through these mechanisms and equally clear that narcotics traffickers and other elements of organized crime, illegal tax protesters and promoters of abusive tax shelters, to name just a few, are intimately involved in these transactions."

An article in the Washington Post for March 26, 1984 described a Federal grand jury indictment of the Omni International Corporation and four of its executives for tax fraud associated with shifting corporate income to a subsidiary located in an off-shore tax haven. The government charged that Omni put \$16.8 million worth of income on its Bermuda subsidiary's books, but only reported \$91,574 of that income on its tax returns.

Money flows related to tax haven transactions are frequently hidden by the secrecy requirements established by foreign jurisdictions. The IRS study of the tax gap completed last year states:

"Indirect evidence suggests that tax haven funds may have been increasing at extraordinary rates. For example, it has been estimated that between 1968 and 1978, international deposits made by non-bank depositors in banks located in all important tax haven areas increased from \$5.3 billion to \$88.7 billion, an average rate of growth of 33 percent per year. Since it is more convenient for U.S. taxpayers to use the facilities of banks in the Caribbean Basin (which are in or near the same time zones as the major U.S. money center banks), it is of some interest that between 1970 and 1978, deposits (excluding deposits held by other banks) in Western Hemisphere tax haven banks increased from \$2.0 billion to \$31.5 billion, an average growth rate of 41 percent per year."

The Chief Counsel of the President's Commission on Organized Crime has stated that, "all too often some banks condone money laundering because the balance sheets draw no distinction between legal and illegal monies." The Bank of Boston recently pleaded guilty to failure to report, as required by law, millions of dollars in cash transactions with foreign banks.

To cope with this problem, IRS has approximately 325 international examiners to handle audits of business operations outside the United States. The majority of these audits involve multinational corporations. However, the spreading use of tax havens requires expanded attention to the operations of individuals, partnerships and trusts. International issues will increasingly become an integral

part of many audits. IRS' existing resources are far too small to deal with this problem adequately, and additional resources should be provided.

The Appellate Division of IRS is under severe strain from mounting caseloads, largely associated with abusive tax shelters, and backlogged inventories at historic highs. The imbalance between workload and resources which we have described in our testimony is nowhere better illustrated than in Appeals. The Administration requests no increase in Appeals staffing for FY 1986. As a result, the backlog of unresolved cases will climb from 70,900 at the end of FY 1984 to 84,100 at the end of FY 1986.

This starkly worsening situation is graphically depicted in the following table:

	<u>Caseload Inventory</u>	<u>Unresolved Deficiencies and Penalties</u>
End FY 1981	27,000	
End FY 1982	50,000	\$12.2 billion
End FY 1983	62,600	\$16.5 billion
End FY 1984	69,200	
End FY 1985	73,500	\$20.0 billion
End FY 1986	84,100	

An increase of 300 Appeals Officers as part of the 1983 revenue initiative was expected to reduce the average caseload to 48 cases. However, workload has continued to grow. The average caseload per Appeals Officer has risen sharply from 63 cases at the end of FY 1983 to 71 cases at the end of FY 1985.

At the same time that the Appeals backlog has been growing, so has the backlog of cases docketed before the Tax Court. The inventory of docketed cases stood at 52,700 at

the end of FY 1982, will rise to 82,400 at the end of FY 1985, and climb to 99,800 at the end of FY 1986. This condition is bound to have severe repercussions upon the Appellate system. The pressure to keep Tax Court caseloads manageable is resulting in expedited settlements in Appeals, something that NTEU predicted two years ago when the Appellate Division was placed under the Chief Counsel's office.

Appeals' agreement rate on cases docketed before the Tax Court increased from 57.1 percent in 1981 to 84.1 percent in 1983 and 83 percent in 1984. Of nondocketed cases, Appeals settled 85 percent in 1983 and 84 percent in 1984. On tax shelter cases alone, Appeals closed 64 percent more cases in 1984 than in 1983. The agreement rate on tax shelter cases rose from 72 percent to 77 percent. Of the tax shelter cases closed in 1984, 7,870 were docketed cases in which agreement was reached before trial, an increase of 88 percent over 1983.

The 1983 Annual Report of the Chief Counsel states that the increased number of agreements avoided unnecessary litigation for both taxpayers and the government and resulted in earlier tax collections. It also states that increased settlements of docketed cases reduced the rate of increase in the Tax Court's tax shelter inventory.

The question remains whether the goal of achieving a fair settlement with the taxpayer is being supplanted by the interest of the Chief Counsel in keeping litigation caseloads manageable. Appeals Officers must be given adequate authority over dispute resolution. They are highly-skilled professionals who, by virtue of their years of experience, are among the most technically knowledgeable in the IRS. Their job is to strive for settlements in the best interests of the taxpayer and the government. We fear

that in the current situation, the extreme pressure that the administrative and judicial system is under will lead to erosion of the quality of settlements in Appeals.

It is incredible that in these circumstances OMB has not allowed additional resources for Appeals. We believe that a minimum of 100 additional Appeals Officers are required immediately, and that IRS should be given the flexibility to assign additional positions to Appeals out of the 2,500 positions recommended for Examination and Appeals in the revenue initiative contained in our alternative budget.

Revenue Agent Attrition

A major problem limiting the effectiveness of IRS enforcement staff is the high rate of attrition among Revenue Agents and Tax Auditors. In FY 1982, the attrition rate for Revenue Agents was 7.5 percent, and for Tax Auditors 8.6 percent (see Table 11). These figures alone fail to present the full dimensions of an extremely serious problem:

- o More experienced Revenue Agents are leaving the Service than inexperienced agents. An IRS study of voluntary separations in FY 1979 showed that losses in GS-9 through GS-13 positions were 63 percent of the total number of Revenue Agent quits that year. The other 37 percent who quit were in grades GS-5 through GS-7.
- o The field offices with the highest quit rates of experienced Revenue Agents are located principally in the Sunbelt states of the Southeast and Southwest.
- o Inadequate salary is the most important factor in this attrition. An article writtine by Richard Whitmore of the Gannet News Service, entitled, "Best Accountants

Leaving IRS for Greener Pastures", states:

"In the past decade, as the salary gap has widened between IRS and private accounting firms, the normal trickle of revenue agents and executives out of the IRS has turned into a flow. Unlike average workers at the Agriculture Department or the Labor Department, for example, many IRS workers have skills that could bring them a lot of money on the outside -- a raise of \$10,000-\$20,000 for an average revenue agent....."

- o The skill and competence of an experienced Revenue Agent makes him a valuable commodity for whom alternative employment opportunities abound. In the article above, Whitmore cites the following case:

"In 1981, at the age of 31 and earning \$35,000, Richard Flowers reached the peak of his IRS career. So, after twelve years with the Philadelphia District Office, Flowers left, looking for a job in private industry with more potential....Flowers got a good raise and limitless potential working as a tax specialist for a Philadelphia energy company."

- o IRS is increasingly unable to compete with the salary scales of the private sector in attracting quality accounting graduates. An IRS study completed in 1981 found that the average starting salary offer to Bachelor's degree candidates in accounting was \$16,728. At the 50th percentile, the salary offer for graduates with a Bachelor's degree in accounting was \$16,800. The starting salary offer at the 10th percentile, above which 90 percent of the offers were made, was \$15,000. These figures compared to IRS starting offers of \$12,266 at GS-5 and \$15,193 at GS-7 level. The study concluded that salary is a critical

factor in the initial recruitment of quality trainees. "Substandard salaries, all else being equal, will result in substantial number of substandard hires."

Between FY 1980 and FY 1982, attrition rates declined for both Revenue Agents and Tax Auditors, reflecting some improvement in the situation. However, this was a period of economic recession, and recovery may kindle a resurgence of the outflow. The forces creating the underlying problem -- the drain of talent, inadequate salaries, inability to compete for quality graduates, and declining experience level of the overall workforce, have persisted and worsened.

Unless remedial action is taken, these conditions will seriously impair the effectiveness of the IRS enforcement staff. Symptoms of this have already begun to emerge. William Penick, a senior partner in the accounting firm of Arthur Anderson, is quoted in the Whitmore article as saying:

"The average agent has less experience, less maturity, and just doesn't have the self-confidence to deal with the issues themselves and work out solutions. The most complex of the tax areas are not black and white and where there are grey areas, you should compromise. The older agent knows from practical experience what makes sense, but the young guys don't have the self-confidence to settle the issues themselves."

Former IRS Commissioner Jerome Kurtz adds:

"You hear a lot of complaints from sophisticated taxpayers that the quality of the people they deal with does not seem the same....what happens is that

frequently the more complex issues are not raised, or are settled on a less-than-optimum basis. There are still a lot of very good revenue agents out there, but you don't see them coming along at the same rate as you used to."

Congress and the Administration need to address the problem of IRS salary scales being out of line with the private sector in terms of both pay and responsibility. For too long, the Federal government has kept the upper grade of an Internal Revenue Agent at the GS-13 level, despite the tremendous growth in complexity of our tax laws and the degree of accounting sophistication with which returns are prepared. A Revenue Agent's responsibility in auditing a complex return of a corporation or partnership today, and the commensurate skills required, are much greater than a decade ago. In order to overcome the starting salary problem, IRS has already begun to hire Revenue Agents at higher entry grade levels. If experienced agents are to be retained, it is essential that the senior grade level for a revenue Agent be raised to GS-14.

The mismatch in relative pay and responsibility between IRS Revenue Agents and their corporate counterparts is well-known and has existed for some time. Whitmore succinctly summarizes it:

"The bottom line is this: A relatively inexperienced \$25,000-a-year revenue agent sitting across the table from a \$60,000-a-year private accountant or comptroller backed up by a \$100,000-a-year tax lawyer."

Congress can help to correct this situation by requiring the Administration to immediately raise the level of a senior Internal Revenue Agent to GS-14. Congress

should establish standards for higher grades in appropriate situations. In addition, it should provide additional pay to permit IRS to attract and retain high calibre Revenue Agents and other occupations where the Service is having recruitment and retention difficulties.

At the same time, IRS should be required to formulate and implement, with Congressional support, an Employee Retention Program covering critical occupations where attrition is excessive. The Employee Retention Program should contain measures designed to enhance the attractiveness of the Revenue Agent's job, upgrade professionalism, provide greater career opportunities, and increase recognition of outstanding performance.

Collection

Collection Division is responsible for collecting delinquent tax accounts and obtaining delinquent tax returns after the taxpayer has failed to respond to written notice. Mounting unpaid tax accounts and nonfiling of required returns have been persistent signals of increasing taxpayer noncompliance in recent years.

It is imperative that Collection activities be fair and executed professionally, because such actions can involve the seizure of a taxpayer's business or other assets. Since a seizure effectively shuts a business down, the interest of the government in protecting the revenue and the interests of the taxpayers, many of whom are small businessmen, must be carefully weighed.

As the representative of IRS employees, we wish to reiterate our conviction that seizures do not make sense in many cases. The taxpayer loses his business and the Federal government loses revenue. Seizures should only be used as a

last resort -- not as a means of improving statistics on some manager's chart.

In order to deal with more than \$20 billion in taxpayer delinquent accounts, Congress added 4,000 new Collection positions in FY 1983. Despite the fact that 200,000 more delinquent accounts are now being closed each year, it is significant that the active inventory of accounts receivable has remained high (more than 1.7 million accounts) for the past three years. This demonstrates that the 4,000 additional positions Congress provided has been just enough to keep pace with current workload, but has not been adequate to make more than a slight dent in the backlog of accounts receivable. Nevertheless, as a result of proposed cutbacks in FY 1986, all but 400 of the 4,000 positions would be eliminated.

The existence of this backlog of 1.7 million delinquent taxpayer accounts, containing \$7.6 billion in revenue, shows that there is ample opportunity to collect additional revenue and strengthen compliance by providing additional Collection resources. Such resources would yield a return of \$19 or more for each dollar spent.

In past budgets, IRS has stated that productivity savings from implementation of the Automated Collection System -- about 1,700 positions -- would be applied to other Collection functions, thereby generating more revenue. That has not been the case, however. Instead, the Administration has applied the saving to reduce Collection staffing by 1,500 positions (200 in FY 1984, 500 in FY 1985 and 800 in FY 1986).

We believe it would have been far wiser for IRS to adhere to its original plan of keeping the Collection staffing level the same, and increasing Collection programs

by 1,500 staff-years. If it had done so, it would have been able to collect an additional 1.2 billion (see Table 1).

NTEU's alternative budget would add an additional 1,000 positions for Collection, enabling 212,000 more taxpayer delinquent accounts to be closed. This would result in collecting an additional \$360 million. More importantly, the backlog in taxpayer delinquent accounts would be reduced. In addition, 84,000 more delinquent returns investigations would be closed, resulting in \$257 million -- for a total revenue gain of \$617 million.

A high rate of attrition among Revenue Officers is preventing IRS from achieving maximum effectiveness in this important enforcement area. The same factor alluded to earlier -- inadequate pay and alternative employment opportunities -- have contributed to this situation.

As discussed earlier in our statement, IRS should implement an Employee Retention Program for Revenue Officers and other critical occupations which are experiencing high turnover. Among the steps that should be taken with the assistance of Congress are a review of pay differentials with the private sector, and increased salary scales to insure that IRS has the ability to compete for qualified individuals in the marketplace. It is essential that the high turnover of Collection personnel in many IRS districts be reduced by comprehensive steps to improve pay, work conditions, and other factors that bear strongly on employee retention.

Assaults and Threats Against IRS Employees

We would like to bring to the attention of Congress the problem of increased danger to IRS employees from threats and assaults stemming from the performance of their duty.

The number of assaults and threats rose from 485 in 1982 to 789 in 1984, a 63 percent increase in two years.

We would like to stress our firm conviction that the vast majority of taxpayers are patient and understanding in their relations with IRS. The problem of assaults and threats is confined to a relatively small number of individuals. Nevertheless, because enforcement action can be perceived by some persons as unjust or a threat to their well-being or lifestyle, IRS employees must be constantly alert to the risk of possible assault, retaliation, or harrassment to themselves and their families.

The problem is particularly acute in the Collection area where Revenue Officers are involved in direct enforcement action, such as seizure of a business or attachment of assets. It has been standard Collection procedure for many years for Revenue Officers to work in pairs in making seizures and to arrange for Criminal Investigation or local police escorts when necessary. Since 1970, Collection has designated High Assault Risk Areas and allowed Revenue Officers to work in pairs in these areas.

Revenue Officers receive training on how to recognize and react to threatening situations that may arise in the performance of their enforcement duties, and what to do if an assault or threat occurs. The training helps to make employees aware of behavior or actions on their part which can contribute to the development of potentially dangerous situations.

Collection has also established an Assault and Threat Reporting System, which requires employees to report all assaults, threats and harassment incidents for investigation by Inspection Branch and follow-up action to provide necessary protection. Analysis of this data for 1981-1984

has revealed that both the number of total incidents and the number of assaults has increased dramatically in the last three years. Analysis also indicates that there is a growing number of taxpayers who are openly hostile to Service employees.

These findings document how more dangerous and stressful the Revenue Officer occupation has become in recent years. Recent shootings of Revenue Officers in Buffalo and Cleveland show how serious the situation is. The hazards and stresses of the occupation are not unlike those experienced by law enforcement personnel, and NTEU believes Congress should consider establishing special retirement for Revenue Officers similar to that provided for law enforcement personnel.

We also strongly urge Congress to impress upon the Department of Justice the necessity for vigorous prosecution of individuals involved in assault, threat, and harassment incidents against IRS employees. Prosecution is an important deterrent that is indispensable to the protection of Revenue Officers, and these employees have the right to expect such support from their government.

Returns Processing

The ten IRS Service Centers will be required to process 179 million primary returns and supplemental documents in FY 1986, an increase of 5 million over 1985 and 14 million in two years. Individual tax refunds will be scheduled for 2.3 million more taxpayers than in 1985, an increase of 5.4 million in two years. The Information Returns Program will have to process approximately 22 million discrepancies involving unreported income.

As is well-known from press accounts, this filing season is not going well for IRS. By March 29, IRS had received 1 percent fewer returns than in 1984, but had processed 26 percent fewer. The number of refunds issued by the end of March was down 29 percent from a year earlier. The lag between the time a return is received and the refund mailed has increased to eight weeks. There are only seven weeks between April 15 and June 1st, after which IRS must pay interest on refunds. If the rate of processing does not improve in the next few weeks, it will end up costing the government money.

Nationwide, 58 percent of returns received at all Service Centers had been processed by the end of March, compared to 77 percent a year earlier. Brookhaven Service Center had processed only 42 percent of returns filed. Philadelphia had processed 42 percent, compared to 79 percent a year earlier. Memphis had processed 65 percent, compared to 81 percent a year ago.

The Philadelphia Service Center is taking ten weeks to process a tax refund -- three weeks longer than last year and twice as long as in 1982.

IRS' explanation has focused on the major computer changeover at all Service Centers under the ADP modernization program. Equipment failures have occurred, and the usual amount of bugs have been encountered. Equipment has been a contributing factor, but it is not the primary factor.

Of greater significance is the increase of 9 million returns, coupled with budget cuts in Returns Processing to levels below those authorized by Congress. This is what has stretched the system thin.

In the FY 1984 Continuing Resolution, Congress authorized 24,297 average positions for Returns Processing. When OMB got finished with this allowance -- after requiring IRS to absorb substantial pay and other cost increases -- the actual number of positions realized was 21,743, or 2,500 positions fewer than the Congressional Appropriation. This came on top of a similar loss of 6,000 positions in FY 1983, as Table 13 shows.

This is the situation that existed in October, 1984 -- just a few months before the onset of the 1985 filing season. IRS was short-changed by 4,200 average positions for returns processing -- the 2,500 mentioned earlier plus 1,700 additional positions needed during the 1985 filing season (see the FY 1985 budget submission, p.21.) Although the number of Returns Processing positions was raised to 23,111 for FY 1985 -- an increase of 1,400 positions -- the horse was already out of the barn door.

We believe that the responsibility for the shortfalls of this filing season can be laid directly at the door of OMB. Its short-sighted budget policies have drained all reserves out of the returns processing system, eliminating the flexibility needed to cope with unforeseen developments such as the extra million in returns growth that occurred this year.

The impact of this short-sightedness is bad enough when the Federal government has to pay interest on taxpayer refunds. But the consequences do not stop there. The increasing complaints of taxpayers about their inability to get through to IRS, the unanswered correspondence and unresolved problems, are a rude jolt to taxpayer confidence in the system.

We must repair the present situation, and repair it fast. Congress should take the lead in doing so, by providing adequate resources for Returns Processing when it considers the FY 1985 Supplemental and FY 1986 budget requests.

I would like to quote now from our testimony last year, when NTEU warned of the folly of the Administration's budget policy. Unfortunately, it went unheeded.

"According to the budget, these [returns processing] programs will require an increase of 1,758 positions -- 512 positions for document matching to identify underreporters and contain the tax gap, 390 positions to implement the Interest and Dividend Tax Compliance Act, 792 positions for increased workload from processing additional returns and issuing more refunds, and 64 positions for automatic data processing modernization.

"The difficulty with the Administration's budget is that after adding these positions, it cuts 2,868 positions and leaves Returns Processing with a 1,110 position reduction overall. This reduction would be taken entirely in WAE personnel, and full-time permanent positions would not be affected. Regardless of how it is made, a staff-year reduction of this magnitude significantly reduces overall capability.

"The Administration justifies its reduction by claiming 2,446 positions as productivity savings, and making a further unspecified reduction of 244 positions. Of the productivity savings, 1,988 positions are to be saved through unspecified efficiencies. The sole justification in the budget for this huge reduction is a paragraph that reads as follows:

(6) Managerial and Employee Performance -- Efficiencies (1,988 average positions) should be achieved in processing tax returns through efforts at improving employee productivity, assuming continued availability of skilled labor and merit performance.

"We are prepared to be open-minded on the matter of these productivity increases, but without further evidence we remain dubious. Since a cut of this magnitude would wipe out the entire program increase (1,758 positions) deemed to be essential, it jeopardizes IRS' ability to achieve the performance levels it projects in this budget. How can 719 million interest and dividend information returns be processed, and 4.8 million underreporter notices be issued in FY 1985 if this 2,868-position cut is made and the productivity savings do not materialize?

"We believe that it would be unwise to predicate Returns Processing performance, which involves such sensitive matters as issuing refunds and maintaining taxpayers' accounts, on the prospect of achieving so large a saving."

We strongly urge the Subcommittee to approve the NTEU alternative budget for Returns Processing for FY 1986, which restores the cuts made by the Administration and provides the resources requested in the budget for the anticipated growth in the number of primary and information returns filed. We believe these 24,000 average positions to be the minimum resource level required for this important function.

Taxpayer Service

The Administration has again seen fit to flout the intent of Congress and seek a significant reduction of Taxpayer Service, amounting to 225 average positions below

the FY 1984 level, which Congress directed to be maintained. We strongly believe that our tradition of voluntary compliance depends on the taxpayer's willingness and ability to self-assess his tax and file a return, and Taxpayer Service contributes importantly to this end.

Moreover, the increasing complexity of the tax code has led to a steady growth in the number of taxpayers requesting IRS assistance. This is shown in Table 14. Whereas in 1976 the number of taxpayers requesting IRS assistance was 52 percent of the number filing individual returns, by 1984 the proportion had risen to 63 percent.

We estimate that by FY 1986, 66 million taxpayers will request IRS assistance, mainly through the toll-free telephone system, but also through correspondence and walk-in service. Of this number, 45.3 million or 69 percent will be assisted if the Administration's budget is approved. This will be the lowest percentage assisted in a decade, as Table 14 shows.

Additional resources are clearly required to curb this decline, but the Administration's budget fails to provide them.

NTEU's alternative budget would provide 260 additional positions for Taxpayer Service, at a cost of \$8.6 million. This would permit assisting 50 million taxpayers, 5 million more than in the Administration's program. Under NTEU's program, the percentage of taxpayers assisted would be 76 percent - the same level as the current fiscal year. This means that IRS would help three out of every four taxpayers requesting assistance. As the Taxpayer Service system is under severe strain, we believe this is the lowest service level that we can safely tolerate.

We strongly urge the Congress to approve the additional 260 positions for Taxpayer Service. We must recognize that the demand for taxpayer service is rising as the complexity of the tax code increases and tax law changes are made more frequently. We believe that helping three out of four taxpayers requesting assistance is the minimum service level that IRS should strive for. This cannot be achieved without additional resources, and we look to Congress to provide these funds.

Conclusion

In conclusion, Mr. Chairman, we strongly urge Congress to approve a budget which substantially increases the resources available to IRS in FY 1986. The minimum increase that should be considered, if we are to maintain FY 1985 program levels and accommodate normal workload growth, is NTEU's recommendation for 2,860 additional staff-years and \$233.8 million. This would raise \$1.1 billion in FY 1986, and \$5.5 billion over the period FY '85-'89, over the revenue that would accrue under the Administration's budget request. However, NTEU would go farther and advance the Administration's proposed 2500 position revenue initiative from FY 1987-89 to FY 1986-88. This would raise an additional \$1.5 billion in FY 1986 and \$4.6 billion over the three-year term of the program. To achieve this, we recommend approval of NTEU's alternative budget for FY 1986, for \$3.8 billion and 92,000 average positions (Table 4).

Congress has a rare opportunity not only to reverse the trend of deteriorating voluntary compliance, but to raise significant revenues during a time of crisis in the Federal budget. The enormous size of the tax compliance gap means that additional revenues can be rapidly obtained. The success of the revenue initiative of two years ago bears this out. Both the Congressional Budget Office and the

General Accounting Office, chief advisors to the Congress in these matters, have emphasized the revenue yield to be gained when relatively small increments of resources are added to the tremendous plant already in existence.

In closing, allow me to pay tribute to the thousands of men and women who collect the revenue of the Federal government. They maintain, with skill and devotion, the integrity of one of our most vital institutions. Recently, you may have read about the results of the Yankelovich Public Opinion Survey which IRS commissioned last year. It found tht a substantial majority of the American people -- about 60 percent -- believe IRS to be trustworthy, accurate, and staffed by knowledgeable people. The dedicated employees of IRS have worked hard to earn this trust, and I can assure you they will continue to strive for even higher levels of service to the American taxpayer.

Mr. Chairman, I appreciate the opportunity to appear before you today. I am prepared to answer any questions you may have.

APPENDIX A

Methodology for NTEU's Revenue and Cost Calculations

NTEU's revenue and cost calculations are based upon data contained in the IRS budget submission.

Examination. NTEU's methodology relates additional staff-years to additional exams, and additional exams to additional revenue, based upon data at pages 38-39 of the budget submission. FY86 projected data is used to make the computation, and this is subsequently checked using FY84 actual data.

- (1) To compute the impact of 400 additional staff-years, add 400 to 18,112 revenue agents and tax auditors for FY86. Using simple proportion, if 18,112 staff-years yield 1,373,000 exams, then 18,512 will yield 1,403,000 exams, or 30,000 more.
- (2) Again, if 1,373,000 exams yield \$14.0 billion in revenue, then 1,403,000 will yield \$14.3 billion, or \$300 million more.
- (3) If 30,000 additional exams produce \$300 million, the average return is \$10,000 per exam in FY86. Using FY84 (actual) data, 1,418,000 exams yielded \$14.2 billion in additional assessments (taxes, penalties, and interest) or, \$10,000 per exam.
- (4) To obtain an estimate of the incremental return at the present level of operation, note that p.37 of the submission states that the FY82-84 revenue initiative (1,000 additional staff-years for Examination) yielded \$1 billion in additional assessments in FY84. The cost of 1,000 staff-years, at \$35,000 per staff-year, is \$35

million, or a 28:1 return. Also, last year's budget stated that \$807 million was produced by the initiative in FY83. Over the two-year period, FY83-84, \$1.8 billion was generated at a cost of \$70 million, for a 25:1 return.

- (5) The incremental cost of 400 additional positions in Examination, at \$35,000 per staff-year, is \$14 million. The incremental revenue computed above is \$300 million. The return is 21:1. Since this is less than the incremental return computed above, it is accepted as a reasonable approximation of the return that can be expected at the present level of operation in Examination. An explanation of the relatively high return (net return, after deduction of cost, is 20:1) is that the total number of examinations has been falling for the past 5 years, and IRS has been concentrating its efforts on the more lucrative exams.
- (6) IRS' own estimate of incremental return is 20:1. During FY87-90 it plans to add 2,500 positions at a cost of \$75 million and generate \$1.5 billion a year in revenue, a 20:1 return. See page 6 of the budget.

Collection. The methodology is the same, except that the additional 1,000 staff-years must be applied to the two basic Collection activities, taxpayer delinquent accounts (TDA's), and taxpayer delinquent returns investigation (TDI's) of non-filers. In this case, it was assumed that 800 staff-years would be applied to TDA cases and 200 to TDI cases. Data used are on pages 57-58 of the budget submission.

(1) TDA computation:

$$\frac{12,452}{3,299} = \frac{13,252}{x} \quad x=3,511 \text{ case closures for 800 additional positions}$$

$$3,511 - 3,299 = 212,000 \text{ additional case closures}$$

$$\frac{3299}{5609} = \frac{3511}{x} \quad x = \$5,969$$

$$\$5,969 - \$5,609 = \$360 \text{ million additional revenue collected from TDA's}$$

(2) TDI computation:

$$\frac{3469}{1461} = \frac{3669}{x} \quad x=1545 \text{ case closures for 200 additional positions}$$

$$1545 - 1461 = 84,000 \text{ additional TDI closures}$$

$$\frac{1461}{4466} = \frac{1545}{x} \quad x = \$4723$$

$$\$4723 - 4466 = \$257 \text{ million additional revenue collected from TDI's}$$

$$(3) \text{ FY84 revenue per TDA: } \frac{5159}{3244} = \$1,590$$

$$\$1,590 \times 212,000 \text{ TDA's} = \$337 \text{ million}$$

$$\text{FY84 revenue per TDI: } \frac{5105}{1646} = \$3,100$$

$$\$3,100 \times 84,000 \text{ TDI's} = \$260 \text{ million}$$

The data projected for FY86 checks with FY84 experience. The return per TDA is somewhat higher in FY86 than in FY84, but this is reasonable in light of improved collection methods.

- (4) To obtain an estimate of the incremental return in Collection, note that p.56 of the budget submission states that the FY82-84 revenue initiative (4,000 additional staff-years for Collection) produced an additional \$1.9 billion in revenue in FY84. The cost for these positions was \$100 million (\$25,000 per staff-year in FY84). The incremental return is 19:1.
- (5) The incremental cost of 1,000 positions in Collection is \$30 million for FY86 (\$30,000 per staff-year). The incremental return is \$617 million. The return ratio is 20:1, which approximates that achieved in FY84.

Return Processing. Direct revenue yield can be attributed to the Information Returns program. IRP is a single system that operates with staff from Returns Processing, Examination, and Collection, as shown on pages 14-15 of the budget submission. Enhancement of the Return Processing component generates more discrepancy leads, and these are followed up in Examination and Collection.

(1) As the budgetary data shows, the plan is for 263 fewer staff-years in the Returns Processing component in FY86, and the impact of this is 651,000 fewer underreporter notices issued. By restoring these positions and adding 300 additional positions, more leads can be generated and notices issued. This generates additional revenue.

(2) Dividing total revenue by total cost of all IRP positions yields an average return of 13:1 in FY84 and 12:1 in FY86. Thus, 12 times the cost of the 560 additional

Returns Processing positions (\$16.8 million) yields \$202 million in revenue attributable to those positions.

(3) The cost of a Returns Processing staff-year in IRP is \$30,000 (derived from page 14). The cost of a non-IRP staff-year is \$24,000. The cost of 1,100 staff-years (560 IRP and 540 non-IRP) is computed as follows:

$$560 \times \$30,000 = \$16.8 \text{ million}$$

$$540 \times 24,000 = \underline{\$13.0 \text{ million}}$$

$$\text{Total} \quad \$29.8 \text{ million}$$

Average Staff-Year Costs. Average staff-year costs are derived from budget data contained in the second page of each division budget submission. The average costs used in this study are:

Returns Processing

IRP Program	\$30,000
Other	23,700
Examination	34,480
Collection	26,480
Appeals	44,000
Taxpayer Service	33,000

Comments. Comments on this methodology should be addressed to NTEU.

TABLE 1

REVENUE LOSS RESULTING FROM ADMINISTRATION'S
FY86 BUDGET REQUEST FOR IRS

	Revenue Loss ¹ (Millions)
<u>Returns Processing</u>	
Fewer Underreporter Notices	220
<u>Examination and Appeals</u>	
Fewer Examinations	200
<u>Collection</u>	
Fewer Taxpayer Delinquent	
Accounts (TDA's) Closed	585
Fewer Delinquent Returns	
Secured from Non-Filers	<u>639</u>
<u>TOTAL</u>	1,644

¹Based on comparison of FY86 level in the budget to FY84 actual program, except for:

(a) Returns Processing, where the FY85 program is used as the baseline because of the major increase in Information Returns Program resources between FY84 and FY85; and

(b) Taxpayer Delinquent Accounts (TDA's), where the FY85 congressional appropriation is used as a baseline.

TABLE 2

INTERNAL REVENUE SERVICE FY 1986 BUDGET REQUEST AND NTEU RECOMMENDATION

	FY 1985		FY 1986		Increase (+) or Decrease (-)		NTEU Recommended Addition to Restore to FY85 Level and Provide for Workload Growth 2		NTEU Recommended Appropriation For FY 1986	
	Appropriation (Continuing Resolution and Supplementals) 1		Budget Request							
	Amount (\$000)	Avg. Pens.	Amount (\$000)	Avg. Pens.	Amount (\$000)	Avg. Pens.	Amount (\$000)	Avg. Pens.	Amount (\$000)	Avg. Pens.
Salaries & Expenses	107,347	2240	95,932	2071	-11,415	-169			95,932	2071
Processing Tax Returns	989,507	23,187	998,241	22,846	+8734	-341	+72,970	+1103	1,071,211	23,949
Examination & Appeals	1,384,270	35,354	1,375,302	35,456	-8968	+102	+71,047	+513	1,446,349	35,969
Investigation Collection & Taxpayer Service	1,093,474	27,764	1,041,725	26,116	-51,749	-1648	+89,806	+1244	1,131,531	27,360
TOTAL	3,574,598	88,545	3,511,200	86,489	-63,398	-2056	+233,823	+2860	3,745,023	89,349

1. Includes \$33 million over the Administration's pay supplemental request for FY 1985, required to restore 802 positions cut by OMB's allowing only 50 percent of the pay requirement (\$66 million) to be requested. Since 200 positions would be cut in examination and 500 positions in collection, there would be a loss of \$448 million in revenue if the cut were made.
2. Includes restoration of program reductions and 5 percent pay cut for employees, plus allowances in the budget for processing of additional returns, implementation of the Deficit Reduction Act of 1984, and other increases to maintain current levels. Amounts are extracted from page 2 of the Congressional Budget Submission, and do not include non-recurring costs.

TABLE 3

NTEU FY 1986 RECOMMENDATION TO MAINTAIN FY 85 LEVELS,
AND NET REVENUE GENERATED, FY 1986-FY 1990

	Recommended Additions for FY 1986 (Staff-Years)	Cost (Millions)	Additional Revenue Assessed and Collected FY 86 (Millions)	Cost FY 86-90 (Millions)	Net Increase In Revenue FY 86-90 (Millions)
Processing Tax Returns ¹	+1,100	30.0	202	1,008	150
Examination & Appeals ²	+500 ^a	18.4	300	1,500	92
Collection ³	+1000	30.0	617	3,085	150
Taxpayer Service ⁴	+260	8.6	-0-	-0-	43
TOTAL	+2,860	87.0	1119	5,593	435

^a400 Examination positions costing \$14 million and 100 Appeals positions costing \$4.4 million.

¹NTEU would restore a planned reduction of 260 positions in the Information Returns Program, and would add 300 more positions for a total of 560. Remaining positions would be used to process the additional 5 million primary returns anticipated in FY 1986.

²NTEU addition would permit 1,403,000 examinations, 30,000 more than the Administration's program. This would provide an overall Examination coverage of 1.23%, instead of 1.20% under the Administration's program. The additional exams would provide additional revenue of \$300 million annually. The increase in Appeals would permit reduction of the large Appeals' backlog of shelter cases.

³NTEU addition would permit closing 212,000 more taxpayer delinquent accounts than the Administration's program. This would result in collecting 5,969 million, an increase of \$360 million. The NTEU addition would also permit closing 84,000 additional delinquent returns investigations of taxpayers who fail to file returns, resulting in \$257 million in additional assessments. Total collection revenue of \$617 million annually would accrue to the Treasury.

⁴NTEU addition would permit assisting 50 million taxpayers, 5 million more than the Administration's program.

NOTE: Methodology for NTEU's revenue and cost calculations is described in Appendix A.

TABLE 4
INTERNAL REVENUE SERVICE FY 1986 BUDGET REQUEST AND NTEU RECOMMENDATION

	FY 1985		FY 1986		Increase (+) or Decrease (-)		NTEU Recommended Addition to Restore to FY85 Level and Implement Revenue Initiative 2,3		NTEU Recommended Appropriation For FY 1986	
	Amount (\$000)	Avg. Pans.	Amount (\$000)	Avg. Pans.	Amount (\$000)	Avg. Pans.	Amount (\$000)	Avg. Pans.	Amount (\$000)	Avg. Pans.
Salaries & Expenses	107,347	2240	95,932	2071	-11,415	-169			95,932	2071
Processing Tax Returns	989,507	23,187	998,241	22,846	+8734	-341	+72,970	+1103	1,071,211	23,949
Examination & Appeals	1,384,270	35,354	1,375,302	35,456	-8968	+102	+158,547	+3013	1,533,849	38,469
Investigation Collection & Taxpayer Service	1,093,474	27,764	1,041,725	26,116	-51,749	-1648	+89,806	+1244	1,131,531	27,360
TOTAL	3,574,598	88,545	3,511,200	86,489	-63,398	-2056	+321,323	+5360	3,832,523	91,849

1. Includes \$23 million over the Administration's pay supplemental request for FY 1985, required to restore 802 positions cut by OMB's allowing only 50 percent of the pay requirement (\$66 million) to be requested. Since 200 positions would be cut in examination and 500 positions in collection, there would be a loss of \$448 million in revenue if the cut were made.
2. Includes restoration of program reductions and 5 percent pay cut for employees, plus allowances in the budget for processing of additional returns, implementation of the Deficit Reduction Act of 1984, and other increases to maintain current levels. Amounts are extracted from page 2 of the Congressional Budget Submission, and do not include non-recurring costs.
3. The Administration's proposed revenue initiative for FY87-89 would be advanced to FY86. It would add 2,500 positions to Examination for 3 years, and raise \$4.6 billion. Estimated cost of the positions is \$87.5 million.

TABLE 5

NTEU FY 1986 RECOMMENDATION WITH REVENUE INITIATIVE,
AND NET REVENUE GENERATED, FY 1986-FY 1990

	Recommended Additions for FY 1986 (Staff-Years)	Cost (Millions)	Additional Revenue Assessed and Collected FY 86 (Millions)	Cost FY 86-90 (Millions)	Net Increase In Revenue FY 86-90 (Millions)
Processing Tax Returns ¹	+1,100	30.0	202	1,008	859
Examination & Appeals ²	+3,000	105.9	1,800	6,100	5,570
Collection	+1000	30.5	617	3,085	2,935
Taxpayer Service ⁴	+260	8.6	-0-	-0-	-43
TOTAL	+5,360	174.5	2,619	10,193	9,320

a2,700 Examination positions and 300 Appeals positions.

¹NTEU would restore a planned reduction of 260 positions in the Information Returns Program, and would add 300 more positions for a total of 360. Remaining positions would be used to process the additional 5 million primary returns anticipated in FY 1986.

²NTEU addition would permit 1,578,000 examinations, 205,000 more than the Administration's program. This would provide an overall Examination coverage of 1.45%, instead of 1.20% under the Administration's program.

The increase in Appeals would permit reduction of the large Appeals' backlog of shelter cases.

³NTEU addition would permit closing 212,000 more taxpayer delinquent accounts than the Administration's program. This would result in collecting 5,969 million, an increase of \$360 million. The NTEU addition would also permit closing 84,000 additional delinquent returns investigations of taxpayers who fail to file returns, resulting in \$257 million in additional assessments. Total collection revenue of \$617 million annually would accrue to the Treasury.

⁴NTEU addition would permit assisting 50 million taxpayers, 5 million more than the Administration's program.

NOTE: Methodology for NTEU's revenue and cost calculations is described in Appendix A.

TABLE 6

TOTAL INCOME TAX GAP AND PROJECTION FOR

1982-1990 (Dollars in Billions)						
Tax Year	Personal Income 1	Voluntary Reporting Percentage 2	Individual Unreported Income 3	Individual Tax Compliance Gap 4	Total Income 5 Tax Gap	Individual Income Tax Receipts 6
1976	1,391	90.4	132	32.2	39.2	132
1977	1,538					158
1978	1,722					181
1979	1,944	89.8	195	50.6	62.3	218
1980	2,160					244
1981	2,404	89.3	250	68.5	81.5	286
1982	2,579	89.1	281	76.0	90.0	299
1983	2,744	88.9	305	82.0	98.0	290
1984	3,013	88.7	340	92.0	110.0	296
1985	3,241	88.5	373	101.0	120.0	330
1986	3,483	88.5	401	108.0	129.0	359
1987	3,747	88.5	431	116.0	138.0	393
1988	4,019	88.5	462	125.0	149.0	434
1989	4,312	88.5	496	134.0	160.0	474
1990	4,596	88.5	528	143.0	170.0	505
Annual Percentage Change (1976-1990)	15.4		20.0	22.9	22.2	18.8

1. From Economic Report of the President and Budget of the U.S. Government, FY 1986.

2. IRS concludes voluntary reporting percentage has been declining at 0.2 percent per annum since 1973. This trend is assumed to continue through 1985, and is then held constant.

3. From IRS, "Income Tax Compliance Research", p.9. Individual unreported income = voluntary reporting percentage x personal income.

4. "Income Tax Compliance Research", p.3. 1982-1990 projected based on 27% of individual unreported income.

5. Individual tax gap is approximately .84 of the total income tax gap, including corporate.

6. See footnote 1. 1989 and 1990 projected at 11 percent of personal income.

TABLE 7

Item 1
Income Tax Gap, 1973 - 1981
(Amounts In Billions Of Dollars)

	<u>1973</u>	<u>1976</u>	<u>1979</u>	<u>1981</u>
Legal sector tax gap, total	28.8	39.2	62.3	81.5
Corporation tax gap, total	3.5	4.6	6.4	6.2
Individual tax gap, total	25.3	34.6	55.9	75.3
Individual income tax liability reporting gap, total	23.8	32.2	50.6	68.5
Nonfilers' income tax liability (Net of prepayments and credits)	0.9	1.4	2.0	2.9
Filers' income tax liability:	22.9	30.8	48.6	65.6
Unreported income	17.3	24.2	38.4	52.2
Overstated business expenses	2.1	3.4	4.7	6.3
Overstated personal deductions ¹	3.4	3.0	5.0	6.6
Net math error	0.1	0.2	0.5	0.5
Individual income tax remittance gap, total	1.5	2.4	5.3	6.8
Employer underdeposit of withholding ²	1.1	0.9	1.8	2.4
Individual balance due after remittance	0.4	1.5	3.5	4.4
Illegal sector tax gap (partial) ³	2.1 (0.8)	3.4 (1.3)	6.3 (2.2)	9.0 (3.2)

¹Includes itemized deductions, personal exemptions, and statutory adjustments.

²Also includes a small amount for underreported withholding by employees and a small negative amount for underclaimed withholding by individuals.

³Includes income from illegal drugs, illegal gambling, and prostitution only. Figures in parentheses are standard errors.

TABLE 8

Item 2
Unreported Legal-Source Income of Individual
Filers and Nonfilers, 1973-1981
(In Millions of Dollars)

	1973	1976	1979	1981
Wages and salaries	33,304	46,274	71,076	94,581
Dividends	1,920	3,638	5,528	8,747
Interest	4,440	6,763	11,548	20,479
Capital gains	5,015	9,935	16,283	17,727
Nonfarm proprietor income and small business corporation income (except informal supplier income)	23,906	32,565	47,246	58,400
Farm proprietor income	5,742	4,542	7,832	9,547
Informal supplier income	10,346	12,721	16,995	17,080
Pensions and annuities	3,123	4,067	6,258	8,799
Rents	1,335	2,390	2,711	3,049
Royalties	312	1,088	1,672	2,770
Estate and trust income	487	695	1,140	1,330
State income tax refunds, alimony, and other income	3,990	6,857	6,260	7,166
Total income ¹	93,919	131,535	194,548	249,675

¹Total may not equal sum of components due to rounding.

TABLE 9

Item 3
Voluntary Reporting Percentages for Individual
Filers and Nonfilers, by Source of Income, 1973-1981

	<u>1973</u>	<u>1976</u>	<u>1979</u>	<u>1981</u>
Wages and salaries ¹	95.4	94.9	94.4	93.9
Dividends	90.7	87.1	85.7	83.7
Interest	87.6	88.1	86.3	86.3
Capital gains	75.7	64.3	63.4	59.4
Nonfarm proprietor income and small business corporation income (except informal supplier income)	84.0	82.2	80.7	78.7
Farm proprietor income	88.6	92.6	89.5	88.3
Informal supplier income	20.7	20.7	20.7	20.7
Pensions and annuities ¹	81.5	85.3	85.0	85.2
Rents	94.7	94.0	95.4	95.6
Royalties	74.3	65.6	64.2	61.2
Estate and trust income	82.0	79.2	75.7	76.2
State income tax refunds, alimony, and other income	66.0	55.2	62.3	62.0
Total income	<u>91.2</u>	<u>90.4</u>	<u>89.8</u>	<u>89.3</u>

¹ Before correcting for pensions misreported as wages. After this correction the VRP's affected would be modified as shown below:

Wages and salaries	95.3	94.9	94.4	93.9
Pensions and annuities	83.5	86.9	86.7	86.9

TABLE 10

RETURNS EXAMINED AND AUDIT COVERAGE
FY 1978- FY 1984

Fiscal Year	INDIVIDUAL		PARTNERSHIP		CORPORATION	
	<u>Number Examined</u>	<u>Audit Coverage (%)</u>	<u>Number Examined</u>	<u>Audit Coverage (%)</u>	<u>Number Examined</u>	<u>Audit Coverage (%)</u>
1978	1,845,242	2.16	27,828	2.44	147,340	8.01
1979	1,844,986	2.11	30,474	2.55	142,937	7.44
1980	1,833,858	2.02	23,041	1.79	133,593	6.48
1981	1,644,104	1.77	22,113	1.62	107,363	5.05
1982	1,455,256	1.55	23,084	1.63	107,705	4.73
1983	1,427,660	1.50	36,115	2.41	85,980	3.64
1984	1,215,927	1.27	25,086	1.57	65,803	2.66

TABLE 11

SEPARATION RATES FOR KEY IRS OCCUPATIONS

<u>Fiscal Year</u>	<u>Revenue Agents</u>	<u>Revenue Officers</u>	<u>Tax Auditors</u>
1967	10.4	11.1	12.4
1968	10.4	11.0	11.0
1969	8.9	7.2	7.5
1970	8.6	7.9	9.1
1971	6.8	8.2	12.0
1972	6.6	7.3	10.3
1973	7.8	8.3	10.6
1974	6.4	7.4	11.7
1975	6.4	6.6	9.6
1976	4.7	6.0	7.0
1977	7.5	7.3	9.5
1978	8.6	8.4	10.9
1979	10.5	9.3	10.0
1980	11.6	9.9	11.2
1981	8.1	8.0	8.5
1982	7.5	8.0	8.6

Source: Internal Revenue Service

TABLE 12

INTERNAL REVENUE SERVICE
Employment History
Selected Occupations
(Average Positions)

Fiscal Year	Revenue Agents	Tax Auditors	Revenue Officers	Special Agents	Appeals Officers
1901 Actual	13,272	4,079	5,323	2,751	935
1902 Actual	13,554	3,000	6,020	2,605	821
1903 Actual	13,613	3,021	7,301	2,593	891
1904 Actual	13,405	3,459	7,527	2,790	1,031
1905 Authorized	14,237	3,767	7,408	2,793	1,073
1906 Estimate	14,351	3,761	7,369	2,791	1,090
Change					
Number	114	-6	-19	-2	17
86 over 05	1,079	-310	2,066	41	255
Percent	0.80%	-0.16%	-0.26%	-0.07%	1.50%
86 over 01	0.13%	-7.00%	38.01%	1.45%	30.54%

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TABLE 13

INTERNAL REVENUE SERVICE
AVERAGE POSITIONS APPROPRIATED VS. ACTUALLY REALIZED
FY 1983-85

<u>Total IRS</u>		
<u>Fiscal Year</u>	<u>Appropriated By Congress</u>	<u>Average Positions Realized</u>
1983	90,364	83,494
1984	89,282	87,508
1985	88,506	87,743
<u>Returns Processing</u>		
1983	26,367	20,533
1984	24,297	21,743
1985	23,187	23,111

Source: IRS Budget Submissions and Budget Briefing for NTEU.

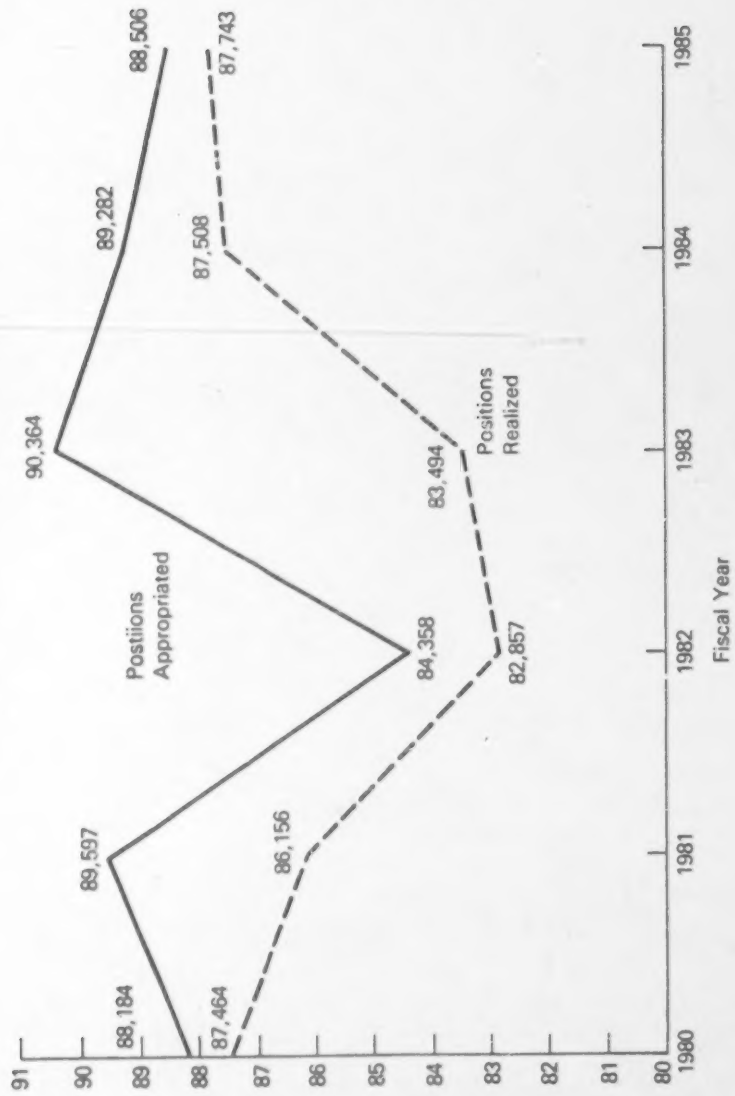
TABLE 14
NUMBER OF TAXPAYERS REQUESTING IRS ASSISTANCE VS.
NUMBER ACTUALLY ASSISTED
FY 1976-1986

FY	(1) Number of Taxpayers Filing Individual Returns (millions)	(2) Number of Taxpayers Requesting IRS Assistance ¹ (millions)	(3) Percent Requesting Assistance ²	(4) Number of Taxpayers ³ Assisted (millions)	(5) Percent Assisted ⁴
1976	85.6	45.0	52%	41.9	93%
1977	86.4	47.0	54%	40.2	86%
1978	87.4	44.7	51%	38.0	85%
1979	90.8	48.6	53%	41.0	84%
1980	93.2			43.0	
1981	94.0			44.8	
1982	95.5			47.4	
1983	95.3			47.1	
1984	96.3	60.8	63%	50.1	82%
1985	101.4	63.9	63%	47.6	74%
1986 (Adminis- tration proposal)	104.4	65.8	63%	45.3	69%
1986 (NTEU Alternative)	104.4	65.8	63%	50.3	76%

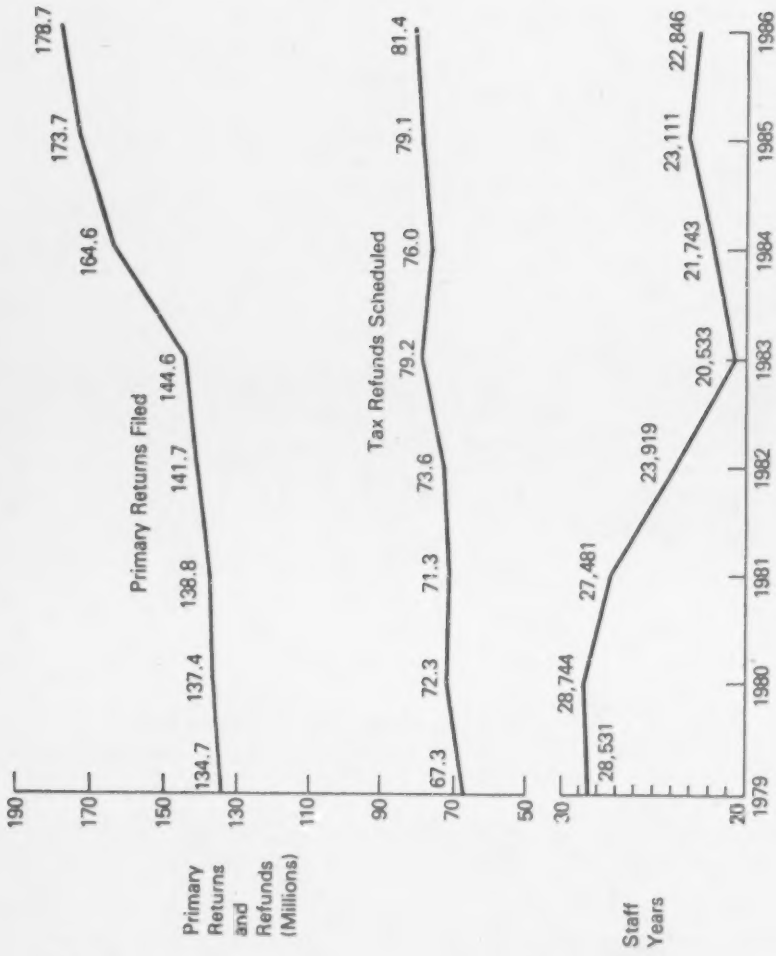
TABLE 14 (Continued)

1. This column reflects demand for taxpayer service. It includes IRS' estimate of the actual demand on the toll-free telephone system, not just the number of calls answered. For example, in FY 84 demand was 52 million while calls answered were 41.3 million. Taxpayers seeking walk-in and correspondence assistance are also included. After 1984, the figure is projected by taking 63% of the number of filers.
2. Column 2 as percent of column 1.
3. Source: IRS budget submissions. Data cover toll-free telephone, walk-in, and correspondence. Figures do not include tele-tax or outreach programs.
4. Column 4 as percent of column 2.

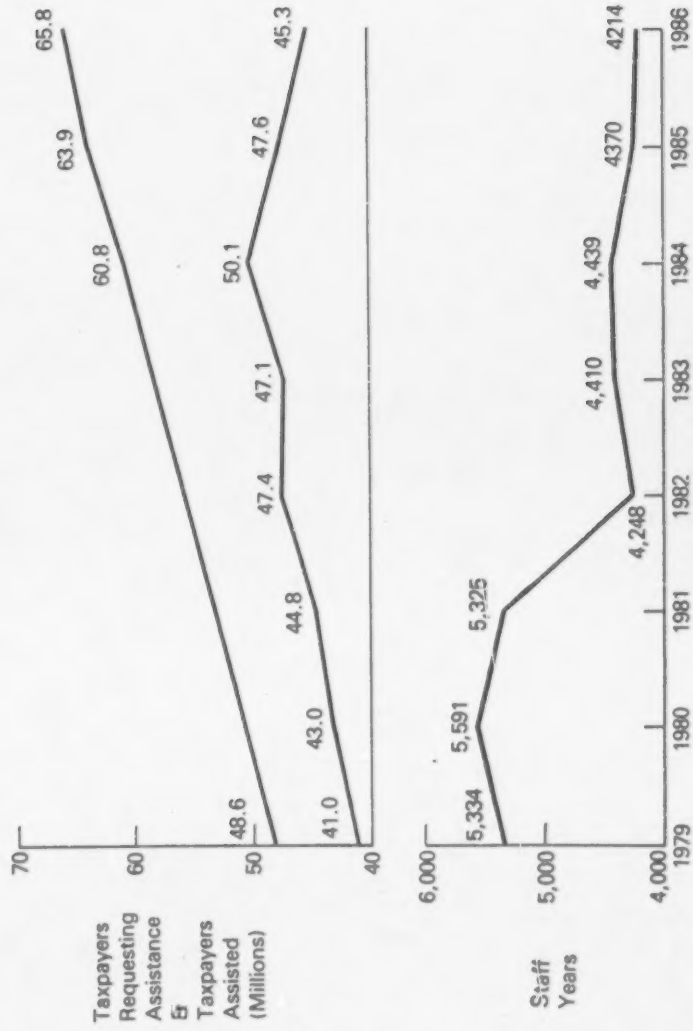
INTERNAL REVENUE SERVICE



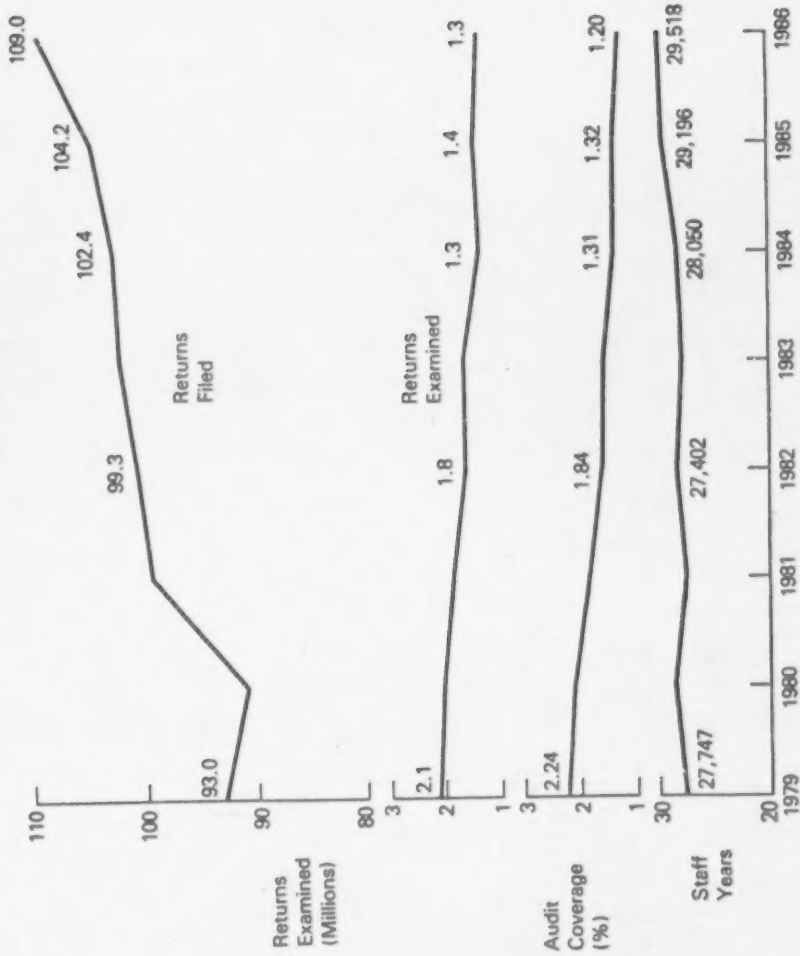
Returns Processing



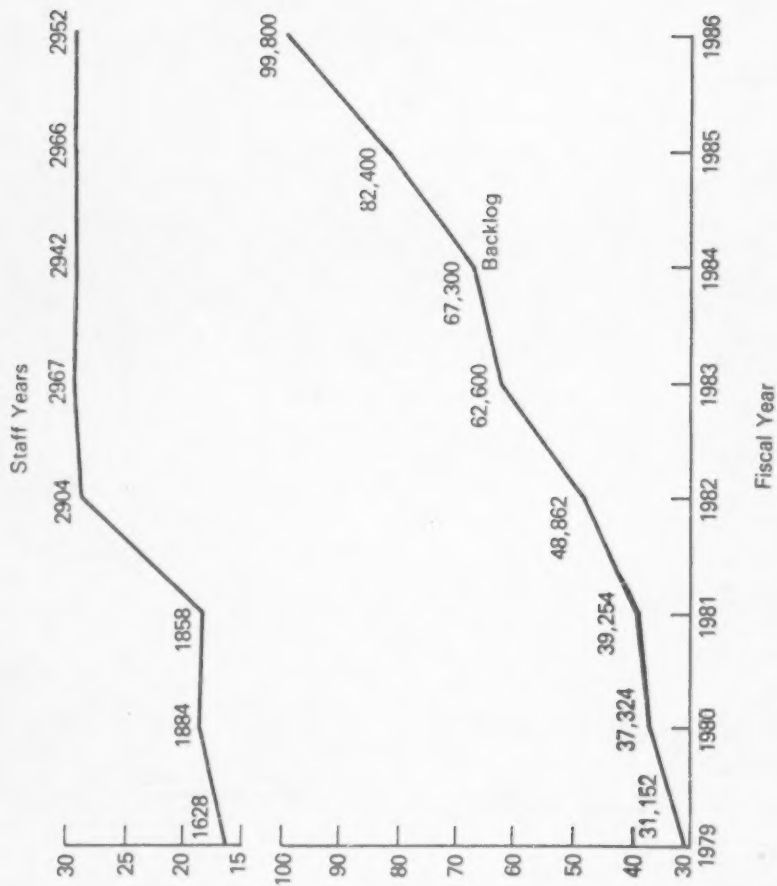
TAXPAYER SERVICE



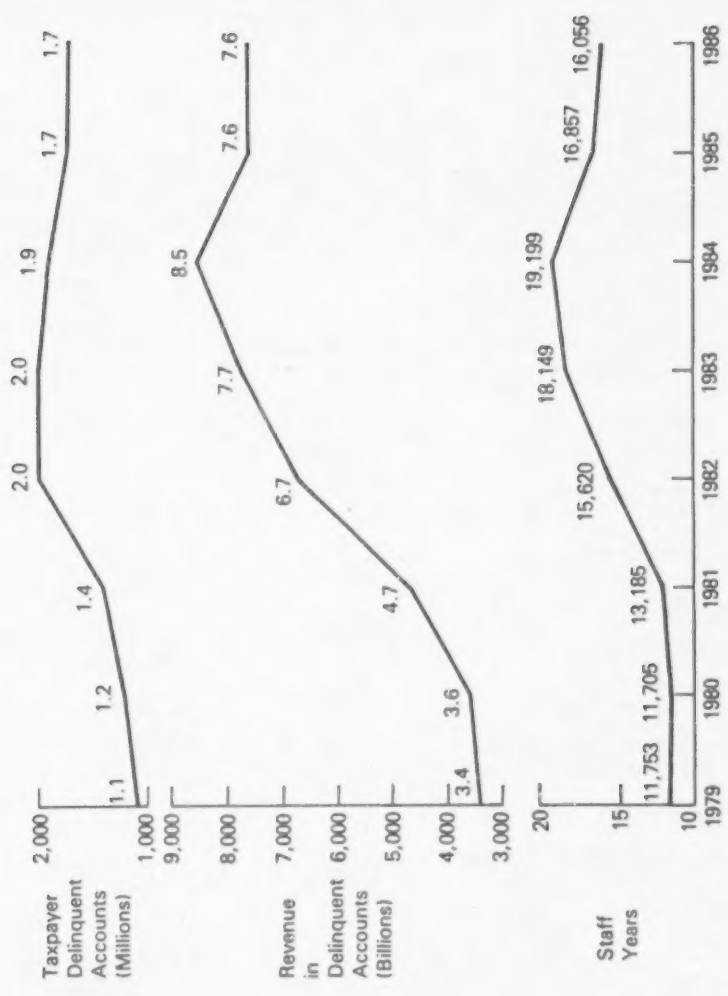
Examination



APPEALS



COLLECTION



REAGAN TAX ADMINISTRATION: A LOSING SCORECARD

	<u>1980</u>	<u>1985</u>	<u>Reagan/OMB Proposal 1986</u>
Total IRS Positions	87,464	87,743	86,489
Returns Filed			
Primary	137.38 Mil.	173.7 Mil.	178.7 Mil.
Information	547 Mil.	968 Mil.	1,046 Mil.
Voluntary Compliance Rate	82.1%	81.7%	81.6%
Income Tax Gap (Money Owed But Not Collected)	\$62 Bil.	\$87 Bil.	\$92 Bil.
Number of Tax Returns Examined	2,179,000	1,454,000	1,373,000
Percentage of Tax Returns Examined	2.1%	1.3%	1.2%
Revenue From Returns Examined	\$6.3 Bil.	\$14.1 Bil.	\$14.4 Bil.
Number of Delinquent Accounts	1.2 Mil.	1.7 Mil.	1.7 Mil.
Uncollected Tax Revenue in Delinquent Accounts	\$3.6 Bil.	\$7.6 Bil.	\$7.6 Bil.
Collected Tax Revenue From Delinquent Accounts	\$7.8 Bil.	\$22.3 Bil.	\$22.7 Bil.
Returns Processing Staff	28,746	23,111	22,846
Direct Taxpayer Assistance Staff	5,591	4,370	4,214

NTEU PLAN - FY 1986

	<u>Amount</u>	<u>Positions</u>
Administration's Budget Request .		86,489
NTEU Plan		
Returns Processing	+\$ 30,000 Mil.	+ 1,100
Examination and Appeals	+\$105,900 Mil.	+ 3,000
Investigation, Collection	+\$ 30,500 Mil.	+ 1,000
Taxpayer Service	+\$ 8,600 Mil.	+ 260
NTEU Budget Recommendation		
Additional Staff over 1985		
Authorized Level - Total		
Additional Cost	+\$174,500 Mil.	+ 5,360
		<u>91,849</u>

ADDITIONAL ASSESSMENTS/COLLECTIONS FROM NTEU PLAN

	<u>FY '86</u>	<u>FY '86-'90</u>
Examinations and Appeals	\$ 1.8 Bil.	\$ 6.100 Bil.
Collection	.617 Bil.	3.085 Bil.
Information Returns Program	<u>.202 Bil.</u>	<u>1.008 Bil.</u>
Total	\$ 2.619 Bil.	\$10.193 Bil.

COMPARISON OF NTEU PLAN
WITH REAGAN/OMB PLAN FOR
FISCAL YEAR 1986

	<u>Reagan/OMB Plan</u>	<u>NTEU Plan</u>
STAFFING:		
Returns Processing Staff	22,846	23,949
Examination and Appeals	35,456	38,469
Investigation and Collection	21,902	22,880
Direct Taxpayer Assistance Staff	<u>4,214</u>	<u>4,474</u>
Total Positions	86,489	91,849

	<u>Reagan/OMB Plan For Revenue Collection</u>	<u>NTEU Plan for Revenue Collection</u>
Number of Tax Returns Examined	1,373,000	1,578,000
Percentage of Tax Returns Examined	1.2%	1.38%
Revenue from Returns Examined	14.4 Bil.	16.2 Bil.
Collected Tax Revenue from Delinquent Accounts	22.7 Bil.	23.3 Bil.
Revenue from Other Sources Including Information Returns Processing	<u>2.0 Bil.</u>	<u>2.2 Bil.</u>
TOTAL REVENUE	39.1 Bil.	41.7 Bil.

IRS TOTAL POSITIONS

1980	87,464
1981	86,156
1982	82,857
1983	83,494
1984	87,508
1985	87,743
1986	86,489 (Reagan/OMB Proposal)
1986	+5,360 NTEU Proposal
	<u>91,849</u>

TAX RETURNS FILED
(In Thousands)

	<u>Primary</u>	<u>Information</u>
1980	137,382	547,000
1981	138,763	645,000
1982	162,814	664,000
1983	171,174	678,000
1984	164,626	692,000
1985	173,743	968,000
1986	178,732	1,046,000

**Income Tax Compliance (Going Down)
FY 1974 - FY 1986**

Voluntary Compliance %

84%

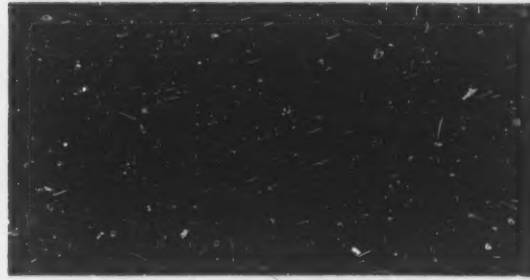
82.1%

81.6%

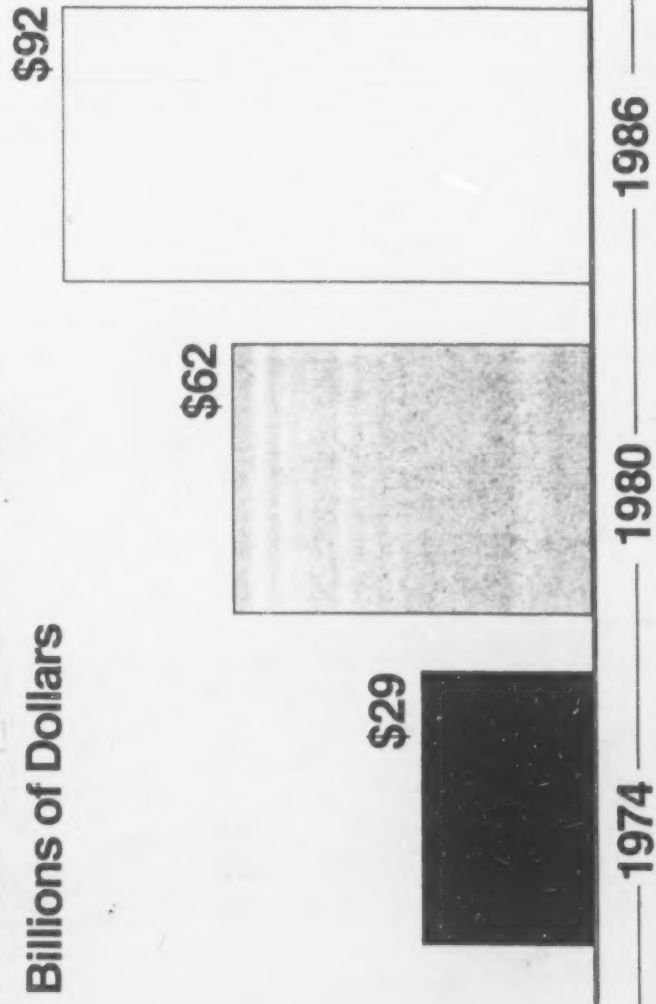
1974

1980

1986



Total Income Tax Gap
(Money Owed But Not Collected)
Fiscal Years 1974 - 1986
Billions of Dollars



EXAMINATION OF TAX RETURNS

	<u>Number of Examined Tax Returns</u>	<u>Percentage of Tax Returns Examined</u>
1980	2,179,000	2.1%
1981	1,930,000	1.84%
1982	1,731,000	1.63%
1983	1,676,000	1.56%
1984	1,418,000	1.31%
1985	1,454,000	1.32%
1986	1,373,000	1.20% Reagan/OMB Proposal
1986	1,578,000	1.38% NTEU Proposal

NUMBER OF DELINQUENT ACCOUNTS
(Millions)

1980	1.2
1981	1.4
1982	2.0
1983	2.0
1984	1.9
1985	1.7
1986	1.7 Reagan/OMB Proposal
1986	1.5 NTEU Proposal

UNCOLLECTED TAX REVENUE IN DELINQUENT ACCOUNTS
(Billions of Dollars)

1980	3.6
1981	4.7
1982	6.7
1983	7.7
1984	8.5
1985	7.6
1986	7.6 Reagan/OMB Proposal
1986	7.2 NTEU Proposal

RETURNS PROCESSING POSITIONS

1980	28,744
1981	27,481
1982	23,919
1983	20,533
1984	21,743
1985	23,111
1986	22,846 Reagan/OMB Proposal
1986	+1,103 NTEU Proposal
	<u>23,949</u> Total

DIRECT TAXPAYER ASSISTANCE STAFF

1980	5,591
1981	5,325
1982	4,248
1983	4,410
1984	4,439
1985	4,370
1986	4,214 Reagan/OMB Proposal
1986	+ 260 NTEU Proposal
	<u>4,474</u> Total

Chairman PICKLE. Thank you, Mr. Tobias, and we will ask Mr. Portney to give his statement.

Mr. PORTNEY. Thank you, Mr. Chairman, I am not going to read my statement but I would like to highlight some points.

**STATEMENT OF GERALD G. PORTNEY, PRINCIPAL, PEAT,
MARWICK, MITCHELL & CO., WASHINGTON, DC**

Mr. PORTNEY. I would like to say at the outset that I am not here representing my firm. I think that the invitation to me was largely based on my spending 26 years in the IRS before leaving, to go to what is euphemistically described as the private sector, and during those 26 years, I did have a major management role in virtually every function of the IRS.

Mr. Chairman, in focusing on the Commissioner's, or the administration's asking for some \$35 million less than the previous year, I would like to emphasize that that is a very deceiving figure, because there is an additional \$100 million which is assumed by the administration to be a reduction that would be effectuated by a 5-percent reduction in Federal pay. And I do fully agree with Mr. Tobias that by Congress not taking any action directly, that it will put OMB in a position of forcing some absorption, additional absorption, which I think, as we have heard today, just should simply not happen.

In looking at Commissioner Egger's testimony today and then going back to March 7 before the Appropriations Committee, I never did get beyond the first of his five major goals of the fiscal year 1986 budget. And the first one was, to maintain essential levels of tax administration. And what I have concluded based on my review of the budget can be summarized by quoting one of Mr. Chairman's very memorable expressions and I think that it is accurate.

Hopefully you will correct me if I am wrong, "That old dog will not hunt."

Now, it seems to me that with a budget document that says that there is going to be a further erosion in compliance, to the extent of \$2.5 to \$3 billion in 1986, it is hard for me to conclude that that is maintaining essential levels of compliance, because what that would suggest is that \$2.5 or \$3 billion that we are giving up in 1986, simply is not essential.

And that is rather hard to believe.

I think that it has been mentioned by an earlier witness, the absolute need to maintain balance, in the IRS programs. We simply cannot have a situation where we are going to go for 4 years and emphasize collection and then let examination go by the board.

That is a very critical problem and the erosion that takes place, simply does not get made up. That becomes almost a structural erosion in the system.

I would also like to comment—it has been brought up before, that from fiscal year 1975, through projected fiscal year 1986, we have seen but a one-half of 1-percent increase in examination resources.

Mr. Chairman, it may be entirely coincidental, and I submit that it may be, but the biggest rise in the tax shelter and tax protester

problems in this country, took place in those very years, and were elevated even more alarmingly during fiscal years 1981, 1982, and 1983, when the Service actually reduced its examination resources. So it seems to me that while it may be coincidental, there may also be a correlation.

Apropos of the tax shelter problems, it seems to me that it does suggest another illustration of what is emerging as a serious allocation of resource situation.

As long as the Service continues to be seriously underfunded, and we are facing a tax gap that continues to increase, I think that the focus needs to be sharper in terms of the allocation of resources. I think that the Service has done a fine job, in stopping the abusive shelter problem, of beginning to turn it around. It has done so at a cost. It has taken resources away from many, many other programs and there are many others around the country, Mr. Chairman, like me, who have no role in aiding, abetting, promoting or encouraging in any way, anything that anybody would consider to be an abusive tax shelter, but who firmly believe the time has come for the Service to announce, perhaps in a major news conference, that it has won and to begin diverting some of those resources to other programs. We are not suggesting that we not look at tax shelters anymore, but the shelter problem has overtaken the system. I think it has resulted in the discriminate function system [DIF] of identifying returns that need to be audited to be basically put on the shelf.

There are a number of districts in this country that simply do not examine any discriminant function selected or identified returns. And I think that the audit lottery problem is a function of that. I think that that needs to be stopped.

I am sorry that the IRS people are not here. My suggestion is that they seriously consider in the interest of achieving or restoring some balance in their program, that would be to come up with some approach to closing out tax shelter cases—and it does not have to be exactly like the pre-1981 so-called cash out of pocket approach to close out tax shelters, but it could be. There are somewhere between 350,000 to 400,000 tax shelter cases in the administrative pipeline. There is a lot of money represented there. It seems to me it is in the interest of sound tax administration to find some way to get those closed without passing them through appeals, which is overworked and passing them on to the tax court, whose docket will reach at year end some 70,000 cases, a significant percentage of which are tax shelters.

I would suggest if the Commissioner and his people view that sort of settlement approach as a form of amnesty, he might want to consider an idea that I have and perhaps it is not original, and that is to say to people that in return for they being able to bail out at this point without having to go to court, and so forth, that the service will commit itself to auditing 1 of the next 3 years returns that that taxpayer files.

And I would suggest to you, Mr. Chairman, that that will enhance the level of compliance among those several hundred thousand people whose shelter cases are in the pipeline.

There has been some reference made, and I think the chairman has done that and I think very pointedly, to the three major tax

bills in the 1980's. It is encouraging for us to hear the acknowledgement as to the impact that that legislation has had on the system. The Deficit Reduction Act of 1984 is probably about 1,400 pages long, and that has been typically followed by technical corrections that runs over 200 pages. It has also been appropriately pointed out that the service did its job and asked for resources and they were absolutely essentially needed resources to implement the Deficit Reduction Act, some 1,060 for fiscal 1985, some 1,624 for fiscal 1986. And OMB's response in total was 290 positions.

It seems to me that once there is a recognition of the fact that it costs when Congress enacts legislation, it costs to implement that; there ought to be no reason why the Service is at least given the necessary resources to do what Congress has instructed it to do. And I think, Mr. Chairman, that there is a way that this committee can solve that problem.

And I would suggest that the committee consider that when a new tax bill is enacted—and I am talking about a tax bill of any significance—that it proceed to instruct the Service either upon enactment or immediately after enactment to provide an implementation plan detailing how the Service proposes to implement that tax legislation. It would be across the board, returns processing, examination, taxpayer service, regulations, rulings; and to also submit to this committee what its resource needs are for that implementation and then to make sure in some way that the Service does in fact get those resources, whether or not OMB supports such a request.

I also think it is important—and I want to reinforce something that Commissioner Cohen, I think in his written statement, emphasized. And that is the need for what we call followthrough funding. It is not enough to give the Service some additional revenue agents because those agents are going to produce work which is then going to be passed on to somebody else. It may go into appeals, and there has to be an appeals officer ready to provide a prompt and effective conference and resolution of that case. It may have to go into litigation. There needs to be an attorney to handle that case.

And I think that it is imperative that when the Service comes in with its budget, that it be required to provide the kind of request for "follow through funding" so that the appropriations process can recognize it.

The taxpayer service problem is a terrible problem. It is magnified greatly by the correspondence and the slowness in responding to it. It seems to me that the likely results of the inability of people to get through on the telephone and the inability of people to get responses in writing from the Service are that there will be a further decline in public confidence, which in turn translates into a further erosion in compliance.

The other function, it seems to me, of that problem is that the Members of Congress will get more and more phone calls and letters. And it seems to me that I am reminded of a commercial that used to be on television fairly often involving oil filters where the message was you can pay me now or you can pay me later. And the cost of that oil filter up front was a heck of a lot less than the cost of a transmission later.

And I really do believe that it would not take a major study to demonstrate that it is a lot cheaper to answer the phone in the first place. There are a number of recommendations that I have made in my prepared statement, and I will not review all of them. I strongly believe that there needs to be some review of the entire role and structure of service centers. Of the 101,000 men and women who were on the IRS payroll on January 19, 1985 in excess of 30,000 are in those 10 service centers.

I have great admiration for these people. They are hard working, loyal, and dedicated. But something has happened in those service centers over these fairly recent years that I think needs to be examined. It may be right; it may be wrong. And that is the service center's role has changed dramatically. It has become much larger in terms of size. It has become much more multifunctional. And it has a much higher degree of direct public contact. And it seems to me that that ought to be looked at in terms of its manageability. Are service centers simply getting too big? I do not know what the answer to that is, but I think the question is important.

In addition to that, from the standpoint of its public contact, because it is not accessible to the public by telephone, it forces taxpayers in communicating to have to sit down and write a letter. If those letters are getting answered promptly, that is one thing. If they are not, I think it creates another problem.

I think that Commissioner Alexander focused on something that perhaps the others did not, and it again goes back to the proliferation of tax legislation. And that is the problem with providing prompt and effective guidance in the way of rulings and regulations. The issuance of technical guidance to the public through the publication of regulations and rulings has been an absolutely essential function over the years. It has gotten more essential because of the increasing complexity that we face today. And it seems to me that in spite of efforts to facilitate publication, the needed guidance is for the most part not being provided timely and in some cases it is not being provided at all.

There is a tension in the system, and there has been for a long time between being right and being responsive. And it seems to me that while being right is important, and I certainly tried when I was associate chief counsel, that sometimes you just have to bite the bullet and say this is about as good as we are going to get and let us go out with it and if we are wrong people are going to tell us about it.

In the meantime, the public is not being served by the vacuum.

I also feel that there is a disturbingly growing confrontational attitude between the Service and the public and those who represent them. I think it probably has a lot to do with the frustration as a result of chronic underfunding, overwork, and a complicated tax system. On the other hand, it seems to me it needs to be dealt with. I have suggested, and I apologize if the term were not an appropriate one, some sort of summit conference where the major national professional organizations, and I mentioned some of them, not to exclude any, but like tax executives, the American Bar Association, the American Institute of CPA's, the National Society of Public Accountants, those who are working with this system day in and day out, and who have a serious, serious responsibility to contribute to

the viability of our tax system, be brought together under a single umbrella for the purpose of beginning to engage in a series of very constructive meetings with the Service to discuss the myriad of problems that are going on day in and day out, and that perhaps collectively there can be resolution.

It seems to me that all the problems today do not require legislative solutions. They do require good faith and a willingness to listen. I am not sure there is enough of that going on.

In any event, I want to thank the chairman and this committee for this opportunity.

[The prepared statement follows:].

STATEMENT OF GERALD G. PORTNEY, PRINCIPAL, PEAT, MARWICK, MITCHELL & Co.,
WASHINGTON, DC

Mr. Chairman, my name is Gerald G. Portney. For the last 20 months. I have been a member of the Firm of Peat, Marwick, Mitchell & Co. in Washington, DC. For the previous 26 years I was a member of the Internal Revenue Service during which I had a management role in virtually every function of the Service. During the last ten years of my career I served as District Director for Maryland and the District of Columbia, Assistant Commissioner (Technical) and most recently, Associate Chief Counsel (Technical).

I welcome the opportunity to appear before this Committee in connection with the Administration's Fiscal Year 1986 Budget Proposals relating to the Internal Revenue Service.

In his statement before the Appropriation Subcommittee on March 7 of this year, Commissioner Egger presented the Administration's FY 1986 budget for the IRS asking for \$30.4 million less than FY 1985 as being in keeping with the Administration's goal of limiting the federal budget by freezing spending. It is actually worse than that by \$100 million which is based upon an anticipated 5 percent cut in federal pay. Certainly to the extent that Congress hopefully rejects any more to reduce the pay of Federal employees, the IRS must either plead for a supplemental appropriation or perform more drastic surgery on a budget that is already unrealistically austere and seriously deficient in dealing with the realities of this albatross of a tax system which has long since exceeded the ability and capacity of the IRS to administer in the manner which the Service and the American public would expect.

Again, referring to his statement of March 7, 1985 before the Appropriations Subcommittee, Commissioner Egger stated that the FY 1986 budget request has five major goals: the first being, "to maintain essential levels of tax administration." With all due respect to the Commissioner, his superiors at the Treasury, to the Office of Management and Budget and whomever at the White House had the responsibility of putting the President's imprimatur on the budget, let me take the liberty of quoting (hopefully correctly) one of Mr. Chairman's many memorable expressions—"that old dog won't hunt." The Service's own estimates of the tax gap would seem to directly contradict that first stated goal of maintaining essential levels of tax administration.

Now I know Commissioner Egger and know that he would not say something he knew was untrue, so when he says the tax gap is currently \$90 billion or so, I must take his word even though in my bones I feel it is higher and probably significantly so.

It is my understanding that Service is on record as saying that voluntary compliance is continuing to fall and is expected to result to a further revenue loss in FY 1986 of \$2.5 to \$3 billion.

Mr. Chairman, it would come as a surprise to more than a few that given the magnitude and urgency of the problem of growing federal deficits and the nature and extent of the cuts proposed, that we can consider foregoing an additional \$2.5 to \$3 billion in revenue, properly due and owing to the United States Treasury, as in effect, non-essential. This budget should be based on bringing to a halt, the deterioration in compliance levels and beyond that, taking sensible and appropriate steps toward recoupment of the tax gap and to begin the long-awaited, much needed rebuilding of the respect for and credibility of our tax system.

Those goals and the accompanying processes are not inextricably intertwined with tax simplification, reform or whatever label people choose to affix to the current and expected proposals aimed at overhauling the current system.

We have passed the halfway mark of the decade of the 1980's and have yet to see budgets with both *balance and sufficient emphasis* on the two mainstream activities designed to achieve compliance and the resulting collection of the revenues, i.e. examination and collection.

The revenue initiatives covering fiscal years 1982-85 inclusive focused on collection. The revenue initiatives for fiscal years 1987-90 inclusive will focus on examination. Both of these functions must be on the playing field at the same time.

It's been acknowledged that collection enforcement has been declining for some years. The rise in accounts receivable and delinquencies in filing are testimony to the inadequacy of resources allocated.

The introduction of the Automated Collection System (ACS) is welcomed as a means of improving productivity. It is however not a short term panacea for a long term problem that has resulted in new record levels of delinquent accounts.

FY 1986 budget does not seek to achieve reductions in these record levels, thereby collecting revenues due and owing to the Treasury, and improving compliance but rather to stay "even with the board." The cumulative effect of the deterioration of collection compliance warrants more than that. The reduction of some \$21 million should be rescinded until agreed upon benchmarks are achieved in reducing both accounts receivable and delinquency investigations.

Meanwhile, audit coverage has continued its decline to a point where we are told that the expected level of FY 1986 will be 1.2 percent which, I believe, sets a new low. I recognize that the Service views "coverage" as a somewhat narrow, if not incomplete measure of its outreach program and instead prefers to add contacts made by IRS Service Centers and characterize the sum total of both as "presence."

The decision to delay the hiring of the first installment of 2,500 examinations personnel until the end of FY 1986 cannot be justified on budget grounds given the acknowledged losses of revenue attributable to reduced compliance. Another year of neglect is unjustified on any grounds. At an investment of perhaps \$45 million, those additional audit personnel could be brought on board and be trained six months earlier.

For FY 1980, the Service's budget showed 28,226 average positions. Six years later, the Administration seeks 28,325 average positions, a net change over a seven year period of 99 average positions or about one-third of one percent. The problem is even greater if one were to go back to FY 1975 and make the same comparison. There is a net increase of 122 average positions over 12 years or less than one half of one percent.

It is perhaps coincidental that two of the most serious compliance problems the Service has faced in many years, tax shelters and tax protestors, experienced their greatest growth during this period.

From a previous and longstanding approach of a balanced examination program, the Service has had to change emphasis and direction. The discriminate function system [DIF] had been used with increasing success to identify returns most in need of review and perhaps audit.

As activity on the shelter and protestor fronts escalated, the Service not only did not have additional resources to respond, but actually had declining resources in FY 1981, 1982 and 1983. As a result, both revenue agents and criminal investigators were deployed in increasing numbers along those two fronts. The became very high if not the highest priorities. The allocation of significant and hard to come by audit staff to the anti-tax shelter program has resulted in commendable progress against the more abusive shelters,—at a price. There are growing numbers of professionals in the tax community who are not sympathetic to abusive shelters nor to those who are part of their promotions, who feel that it is time for the Service to declare victory and begin the repatriation process. Whether it would take the form of allowing out-of-pocket investment as was the case for pre-1981 years or some similar approach is not the key issue. The key issues are prompt, reasonable disposition of large numbers of cases clogging the system, acceleration of the collection of the revenue from these cases and restoring these resources to other programs that have been short changed. Properly done, it can mean the beginning of the end of the "audit lottery" syndrome that has become a part of the American tax system.

I might add that in the event the Service would regard any "settlement" approach to large numbers of pending shelter cases as being somewhat in the nature of amnesty the Service could announce its intention of auditing at least one of the next three years returns to be filed by such taxpayers as a means of assuring compliance.

Mr. Chairman, there are other dimensions to the resource allocation problem which need to be addressed. One of the increasingly debilitating conditions stems from the enactment of new and major tax legislation. If we look at the last four

years, the Service, indeed the tax system, in the larger sense, has been overwhelmed with three major bills in 1981, 1982 and 1984.

The story of the Deficit Reduction Act of 1984 is not unique. Some 1,400 pages of print followed most recently by 225 pages of Technical Corrections. For FY 1985 and 1986, the Service sought 1060 and 1624 average positions respectively, covering all four of it, appropriations to implement that legislation. OMB has supported only 290 average positions for FY 1986.

There can be no doubt that there is a cost to implement new legislation and there can be no doubt about the message that is conveyed when resources are denied and once again, other programs, already understaffed and underfunded are invaded.

Mr. Chairman, I believe the Congress can solve this problem now and for the future irrespective of what the OMB chooses to do. Through this committee, the Service can be requested to provide within a short time after enactment of a new tax bill, an implementation plan that sufficiently details both how the Service plans to implement the legislation and the incremental costs for the next two or three fiscal years. The plan would be useful to this committee in the discharge of its overall role and hopefully in encouraging the appropriations process to take account directly of the additional burdens that the Congress has placed upon the Service.

A similar issue that needs increased attention is that of follow-through funding. Former Commissioner Sheldon Cohen alluded to this in his Dear Roscoe letter of March 20, 1985. For example, it is a given that new audit personnel will generate work that will require support staff in the near term and appeals and legal personnel to deal with disputes that arise later. It would be false economy to not assure follow-through funding.

And speaking of burdens, no group endures more in our system than the citizens to be served. The taxpayer service program continues to be reduced in the competition for resources. In FY 1980, there were 5,533 average positions in taxpayer service. For FY 1986 the Service is asking for the fewest positions in some 12 years, 4,064 or 26.5 percent less than FY 1980. It is my understanding that this level of staffing could result in a new low of 55 percent level of service scheduled next year. What that would mean is that for every 100 taxpayers calling the IRS with a question or a problem in need of a solution, 45 of them wouldn't get through. The likely results of such a condition are (1) a further decline in public confidence which in turn translates into further erosion in compliance and (2) more calls and letters coming into Congressional Offices. I don't believe it would take a major study to demonstrate that it is much less expensive for the IRS to answer the telephone in the first place.

I would try to summarize the overall condition as follows:

The Internal Revenue Service, indeed the tax system, suffers from extraordinary complexity raised to new and seemingly unattainable heights with the continuing onslaught of major tax legislation including the inevitable technical corrections, combines with significant and short-sighted underfunding.

Added to that, is an annual budget process which is inefficient and inconsistent with setting meaningful objectives and allocating resources to, at the least, maintain compliance levels and desirably improve them.

Taken together, the results are only too clear, as is the outlook for continuation of those conditions.

If success breeds success, the corollary would seem to be true.

When I am asked by others some distance beyond the beltway, why the system has hung together as well as it has under the circumstances, I have offered what I feel are the three reasons:

1. There is a core of public attitude that basically goes along with the system out of a sense of patriotism or fear, or both.

2. The political system has a basic appreciation of the importance of a highly professional agency to administer the tax system. Regardless of which party is in power at either end of Pennsylvania Avenue, that wisdom carries over. I served under nine Commissioners and there wasn't a bad choice among them. Also, the lack of intrusion of the political system with the Service's executive and managerial selection process continues to be a positive factor in the administration of the tax system.

3. The third and final reason why I believe the system has survived as it has can be summarized in a single word,—withholding.

It has been with us since World War II and we can speculate that life would be like for the tax collector without it.

Suggestions for dealing with the larger and endemic problems along with those of a narrower, more easily definable nature are available in abundance. Some might suggest the value of each to be reflective of such availability.

Nevertheless, I offer just a few that I feel are doable and could make a difference.

The quest for a simpler system is laudable. Without in any way speculating on the likelihood and timing of achieving such a millenium, I feel the Congress should find a way to adopt a rule which would make it mandatory that each tax bill introduced be accompanied by the tax equivalent of an environmental impact statement. It would be written in language that is understandable by the lay person and that would deal with, among other features, a description of the problem(s) or condition to be dealt with, objective evidence of the existence and extent of the problem or condition, the constituency to be impacted by the solution and at what cost to both that constituency and to the government and what alternatives were considered and rejected. This is not intended to be all-inclusive of the content. If this seems like an especially-burdensome requirement I suggest it be viewed in relation to the burdens which continue to be placed upon the Service and the public by major and frequent tax legislation. I believe very strongly that the capacity of each to assimilate more legislation, more change, was exceeded some time ago.

I feel that this proposal would result in some legislation not seeing the light at the end of the tunnel and appropriately so. Legislation enacted so far in the 1980's has significantly increased both information reporting requirements and also penalty provisions dealing with information reporting and other areas. The problems that these provisions were intended to address were considered serious. I think the time is appropriate for this Committee to examine these very important areas along with the implementation and administration of them and determine their impact on compliance.

Another area worthy of this Committee's interest is one which necessarily flows from the proliferation of legislation—the need to provide guidance so that the intent of Congress can be carried out.

The issuance of guidance to the public through the publication of regulations and rulings has been a necessary and useful function. If anything, it has become even more necessary with the added bulk and complexity provided by the onslaught of tax legislation during these last four years.

In spite of efforts to facilitate publication, the needed guidance is, for the most part, not provided in a timely manner. Some would argue that it is simply not provided. There is often a tension between being right and being responsive.

In the meantime, there are too many vacuums existing. It is not just the law and nature that abhor vacuums—the taxpayers are not pleased, either. Any efforts and encouragement toward the end of providing more guidance, more timely would not only be greatly appreciated, it would also have a salutary effect on compliance.

The role of Service Centers has been evolving over a number of years. Its staffing has grown as has its workload. More importantly, it has become a multi-functional operation engaged in compliance as well as processing activity. Almost one-third of the more than 100,000 people on the IRS payroll as of early January of this year are in the 10 Service Centers. The Service Centers have assumed a large role in generating contacts with the public and yet the public is limited in its form of contact with the Service Centers to the written word. It would be useful to examine the impact Service Centers are having on the public and the opportunities to facilitate and improve communications between taxpayers and the IRS.

In addition to examining the areas of impact on and communication with the public, it would be useful to determine whether the growth and diversity of these installations have exceeded the practical limits of manageability.

Finally, in my statement submitted for the record, I referred to a growing, disturbing perception of confrontationalism between the Service, the taxpayers and those who represent taxpayers. The Service is understaffed, underfunded and underappreciated. The burdens and pressures grow as do tension and frustration levels. The public is reacting. Each side is losing confidence in the credibility of the other. I believe that the quality of communication is seriously inadequate. There is liaison between the Service and various professional organizations at the local, regional and national levels. Those liaison arrangements are useful and should continue but they are not being organized, coordinated and focused to deal with the concerns I am expressing.

And that is why I urge the leadership of the major national professional organizations such as Tax Executives Institute, the American Bar Association, the American Institute of C.P.A.'s, the National Society of Public Accountants, among others to join together in a commitment to make a contribution to the improvement of tax administration.

Before deciding upon solutions, there needs to be a thorough analysis of the problems and that can best proceed by bringing people together to begin a dialog toward

reaching a common goal and it is in the interests of the public and those who represent them to have a better tax system.

All the problems today do not require legislative solutions. They do require good faith and a willingness to listen.

I thank the chairman and his committee for this opportunity.

Chairman PICKLE. Thank you, Mr. Portney, and you too, Mr. Tobias. You both gave us very full statements, and these statements come from two persons who have worked for the Services, worked with the employees, been employees, and certainly have got a background to report to us some of the things we need.

Now, Mr. Portney, I do not think you need to worry about the 5-percent cut. You are just saying that if it did come back, that would be another very serious problem on top of the other cutback?

Mr. PORTNEY. Yes, sir.

Chairman PICKLE. Now, what is going to happen? Your main contention is in many respects the tax shelters have taken over the Internal Revenue system.

Mr. PORTNEY. I believe that that has been the case, and I think that there was a point at which that was the right—it was needed, it was long overdue.

At the same time, what I am suggesting is that I think that it has caused a dislocation, and excessive dislocation of resources to the expense——

Chairman PICKLE. About some 50 to 60 percent of the people use the short form now. They are getting away from some of the shelters in some respects.

Mr. PORTNEY. I think that is fair. As a matter of fact, I cannot stand behind these figures, my recollection is that something like 65 percent of the taxpayers do not itemize deductions. So I suspect that the problem may be somewhat smaller.

Chairman PICKLE. Well, how do we solve our problem? As I understand your testimony, you indicate that we would be foolish to have all these cutbacks, particularly with a 5-percent cut and, therefore, that we are going to reduce revenue, the tax gap is going to get much, much bigger if we do not have the personnel.

Now, you say that as if what the Government is recommending is not acceptable.

Mr. PORTNEY. That is right.

Chairman PICKLE. On the other hand, you said that the IRS is just simply getting too big, we are getting too many people.

Mr. PORTNEY. Well, what I was suggesting, Mr. Chairman, I think the service centers, I think that question ought to be looked at. I am not suggesting to you that the IRS is too big. I am suggesting to you the functions and the nature and the size of service centers has changed very substantially in more recent years. They have become very large. And I think that it is useful to look at those in terms of whether or not the Service ought to be continuing to add more and more responsibilities to service centers as opposed to having some of that work being done in district offices.

But, Mr. Chairman, I wonder if I could make a suggestion to the committee.

With all due respect to those who preceded me today, and I know that you and the other members were asking about how many ad-

ditional employees should the Service have. I have a different approach that I would like to offer.

I would not start that way by saying to Commissioner Egger how many more people can you absorb in time to be productive in fiscal 1986. What I would suggest is an approach as follows: I would say, Commissioner Egger, we have decided to take a page out of OMB's book. You know, you come in here and you have talked about freeze. Well, we want to talk about freeze because that is a term that is understood by you folks in the administration, except we have a little different slant on it. We are going to approach this on a two-step basis. We are going to start with a freeze, and we are going to ask you to tell us what you need across the board activity by activity, program by program, to freeze the erosion in compliance effective with the beginning of fiscal 1986. We do not want to see another dollar lost. We do not want to lose the \$2½ to \$3 billion that you are telling us we are going to lose in fiscal 1986. So we want you to start with the assumption that there is going to be a freeze in the reduction in levels of compliance as of the beginning of fiscal 1986. And we want to know what you need in the way of resources, personnel and support costs to accomplish that objective.

We also want to freeze the increase in the number of delinquent taxpayer accounts. We are impressed with the fact that this \$30 billion, regardless of how you add those numbers, we do not want to see any more increase in the number of delinquent accounts receivable. So we want at the first step a freeze on that level.

You tell us what you need in the way of resources to accomplish that freeze. And I would frankly go on from there. Having done that, I would say in each case you tell us whether you have the ability and the capacity to assimilate what you are saying you would need in the way of additional resources to freeze reductions in levels of compliance and freeze increases in delinquent accounts.

Having got those answers, I would then ask them for step 2 which is to say now we want the turnaround to begin, tell us what you need to begin to improve compliance and to turn around the system.

Chairman PICKLE. Well, we will certainly take that into consideration.

We are not asking the Internal Revenue Service how many more people do you want. We are relating that to the services they need to render and in turn the revenue that the impact would have.

Mr. Tobias, you complained or you voiced concern that the workload given to the individual is so heavy that they have a difficult time to respond. And you in effect say we ought not to have any quotas.

How do we handle the problem within the Internal Revenue Service Center if you do not give them certain responsibilities to perform? None of us are talking in terms of quota but work must be done. You surely are not saying just let the employee do what he thinks he can get done in a day and go home?

Mr. TOBIAS. Absolutely not. I am not suggesting that for 1 minute.

What I am suggesting is that the method of devising the standards is totally arbitrary and totally capricious. And it is totally arbitrary and capricious for two reasons.

First of all, what we have in these centers is shrinking resources, more work, 41 million returns in the last 5 years, 500 million more information returns, 9.1 million more refunds paid out, 5,200 people fewer in those centers doing the work.

Now, if the work is getting done and the computers are down, what that means is that these people are churning out more work. And so what I am saying is yes, you have to have standards, but make those standards reasonable and make them based on what is happening in that center, not based on somebody sitting over there on 1111 Constitution Avenue saying we only have 22,000 people and we got 41 million more returns, we have got to get the work done so that means the standards go up.

Chairman PICKLE. Well, you are assuming that the standards, such as they have, are being set right here, that is, not out in the field, and they have no feeling for what is going on out in the service center?

Mr. TOBIAS. Commissioner Egger testified this morning, he testified this morning that the work allocation standards are set here. He said he decides them and that is how it is done. He says he sets them. And then what happens is that at the end of the second quarter, at the end of the third quarter, if you are one of the five centers below the average in terms of the use of the resources that have been allocated, you get reallocated up to the average. So then that means that has a spiraling effect over the year in terms of what happens in each one of these centers.

So what I am saying is we do not mind standards. You have got to have standards. You have got 30,000 people out there doing many, many different tasks. What I am pointing out is the method of setting those standards is totally arbitrary, capricious based on work allocation, not what is doable.

Chairman PICKLE. All right.

Well, we will look into that too and see if that is the fact.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Along that line, Mr. Tobias, is the National Treasury Employees Union in any way involved when standards are being devised?

Mr. TOBIAS. The answer is, sir, the Civil Service Performance Act, we are excluded from bargaining on those standards. There is one—

Mr. SCHULZE. I am not really talking about bargaining. I am asking whether there is any input or whether your counsel is—

Mr. TOBIAS. The answer is no, except with one small exception, and that is in the last 2 years we have had an incentive pay program experiment going on in four service centers. And it has to do with the direct data entry operators. And what we did was to establish some national program that was implemented locally where local people set targets and set bases, and when they exceeded the targets and bases and increase their efficiency, 50 percent of the increased efficiency went to the employee, 50 percent went back to the Service in cost savings.

Now, that program has been very, very successful in the 4 test centers, and we are moving now to implement that nationwide in all 10 centers. But that is the only area where we have been involved even in a consultative basis in setting those standards. And

where we have been involved, the Service has been extremely pleased.

Mr. SCHULZE. Mr. Egger this morning seemed to state that when they do set these standards, there are those who do not meet them, but there are those who exceed them.

Mr. TOBIAS. That is correct.

Mr. SCHULZE. Is there any pattern to this phenomenon to your knowledge? In other words, can the different performance levels be influenced by training or background, or maybe the educational structure of the work force.

Mr. TOBIAS. Well, there is that. There is the kind of person that you are attracting. The other issue is the amount of turnover. For example, in the Austin Service Center there have been 2,200 people who left the Internal Revenue Service Service Center last year. Now, obviously, that is going to have a very depressing effect on the quality of the work force and how efficient they are. So I do not care what standard you assign to those people, they are not going to make it because they are not trained up.

And the same thing in Philadelphia where you have a lower number of people who return as temporary employees, the WAE return rate. If that is low, then that means more people have to be trained, the learning curve is extended, and the time to get at the optimum production is pushed back from February to March or April. And that again affects how productive these people are.

Now, all of those factors are going to make a difference. All of those factors are going to make a difference in how efficient and how productive each center is from one location to another. And yet those standards are not set with any of that in mind.

Mr. SCHULZE. Is there an optimum training cycle or training set-up which seems to work in one part of the country better than another or in one Service Center?

Mr. TOBIAS. It depends on the job. It is each job. There are many different jobs and the training cycle is different for each of these jobs, depending on what these people are going to do once they are employed so I really could not answer that with any definitivity.

Mr. SCHULZE. You both have referred to abuse of personnel.

But there also have been reports that IRS people are becoming more abusive. Perhaps you should be somewhat introspective and wonder whether or not the reports are accurate. In our business we deal with a lot of people who are on the borderline, as the terminology goes, half a bubble off plumb.

And I am sure you deal with them too. But if your representatives' way of dealing with the public appears aggressive, then you are more likely to provoke that kind of response. I do not know about the cases that were referred to, but we are getting a lot of complaints about the agents who are abusive or aggressive. Perhaps we ought to look at both sides of those complaints.

Mr. TOBIAS. Mr. Schulze, I agree with you. Certainly we cannot tolerate that kind of behavior. But one thing that I would like to say is that what the Commissioner was talking about this morning was the computers and their problem with returns processing. But that again is only one small piece of the problem because that computer not only processes returns in the service center, it also serves

as the information for the revenue officer and the revenue agent in the field.

Now, if I am the revenue officer and I am told that you owe \$500 and you have sent that check in already, but I do not have notice of it because the computer is down and it has not been recorded, and I come out and I say I would like that \$500, sir. You say I have already sent—the check is in the mail. Well, you know that is going to create—you are going to be angry because I am bothering you. I am going to be angry because I do not know whether to trust you or not. I do not know what my supervisor is going to say when I go back and say that the check is in the mail.

Mr. SCHULZE. I understand that. And that is a relatively normal procedure. On the other hand, I do not know that the incoming reports, for instance, can all be laid to the foot of the computer.

Generally speaking it seems I am getting more complaints about aggressive behavior, in the office, and even in audit conditions where there are inferences that the taxpayer is wrong. In other words, the inference is I am going to find something because I know you are a crook. Now, it is not stated in those terms, but the inference is there. And perhaps we ought to look into possible attitudinal changes because these problems have a disintegrating effect on the reputation of the Internal Revenue Service. Take for example a man who has a tax bill for \$300, but eventually he pays. His respect for the Service will certainly diminish if the attitude of those with whom he has been in contact has been abusive. And if that happens and public respect continues to deteriorate, the voluntary compliance structure will suffer. So I think that we have got to be very cautious.

Thank you, Mr. Chairman.

Chairman PICKLE. Our next witnesses are Mr. Mervin Wilf and Mr. Al James Golato. Mr. Mervin Wilf is the chairman of the Section on Taxation of the Philadelphia Bar Association and Mr. Al James Golato is corporate director of public affairs of H&R Block Co.

Mr. Wilf was with us recently, and I believe you came toward the end of the day.

Mr. WILF. Yes, sir.

Chairman PICKLE. And here we are again. Mr. Wilf, if we have a third hearing, we will put you towards the front and let you get even with something. We regret that this happened to you twice, because the bills might come up again. But I hope you can summarize and we will be pleased to hear your testimony.

STATEMENT OF MERVIN M. WILF, CHAIRMAN, SECTION ON TAXATION, PHILADELPHIA BAR ASSOCIATION

Mr. WILF. We welcome the opportunity of being here, Mr. Chairman. We, in the Philadelphia Tax Bar, think we have some kind of a special responsibility because we are almost like being in a vortex of a huge windmill or tornado, call it what you will.

But our mission today is not to recant and recite further horror stories. We come to you with four very specific requests or proposals for taxpayer technical procedure assistance.

We have heard a lot about functions of audits. We do not have any statistical figures. But what we are here really to propose and to emphasize—and what Mr. Schulze suggested—is creating additional respect for the Internal Revenue Service.

I will not bore you with some of the horror stories, but we have four specific requests to make that we think will be helpful to increase taxpayer compliance. If respect for the IRS is increased, it will increase taxpayer compliance.

Now, our four proposals very simply are this. In Philadelphia, at least, we have a Problems Resolutions Office as part of the District Director's office. We have found that—Problems Resolution Office to be enormously successful.

That office consists of individuals who are geared to assisting taxpayers, and they limit their function to assisting taxpayers in a procedural way. They are not there to secondguess an IRS agent in auditing or in determining whether capital gain or ordinary income applies or deductibility or nondeductibility of an item.

I go to them when I have a problem. When you can get to them, they are very helpful. We need more people like that. I think that our experience in Philadelphia is probably the same as throughout the country. It is something which is a relatively new service. It is something in the nature of an ombudsman relationship, and we think it should be strengthened.

So our first suggestion is to increase that very highly desirable function at the district director's office. And, to take a point from Mr. Portney's testimony, perhaps we need something like a taxpayer resolutions office also at the service center, that is, people who are aloof from the service center, but who listen to technical and procedural complaints.

Our second suggestion is some method of stopping the computer. We all hear stories about how the computer goes on and on and on. Also, we understand that steps have to be taken so that information must be fed into the computer rapidly.

We heard Mr. Tobias just a few minutes ago suggest that the check is in the mail, and therefore, if the computer does not show the check has been recorded, the Revenue Officer has no duty but to insist for payment.

We think that we need two things here. We need authorization of people, like the Problems Resolution staff or other people, to turn off the computer when there appears to be a legitimate complaint made by a taxpayer.

And the second thing that we really emphasize is the situation where a taxpayer says to a collection officer, "The check is in the mail," or as we have heard stories, "Here is a copy of the canceled check. Please look at it." The stories that we hear from testimony before this subcommittee and the Senate Finance corresponding subcommittee are that the Revenue Officers are instructed not to look at that canceled check, to disregard it and to insist upon payment again or else the Revenue Officers go through the system of enforcement.

So we propose that, when proof is presented to a Revenue Officer in the collection process of payments made, that that Revenue Officer must immediately cease and desist from proceeding any further and that the matter then be turned over to some entity, like the

Problem Resolution staff, for further processing within a short period of time. Of course, we do not want people taking advantage of that change in procedure. We think that would be a great help.

And the last thing, and it is the easiest thing to provide and something we mentioned in our prior hearing, Mr. Chairman, is additional taxpayer assistance via the telephone. Again today listening to the stories it is hard to get to IRS telephone response. You wear out your finger dialing the telephone.

At the Finance Committee's oversight hearing, one gentleman testified he dialed the number for 5 continuous hours or some such number. It is ridiculous. You just cannot get through, whether it is tax season or nontax season.

In sum, we want to see, by legislation or by persuasion, procedures adopted that will give additional resources and additional sympathy on the technical procedural level to aid taxpayers, not just assistance on the substantive level.

We are not against substantive aid. We are not against additional moneys for audits and things of that type, but we think that what the taxpaying public needs now is a very sympathetic ear at the IRS going along with what Mr. Schulze was saying. Whether or not the perception of the IRS is correct—being hostile—it is there. It is true too often. Steps must be done to correct it, and that is what we came to say today, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF MERVIN M. WILF, CHAIRMAN, SECTION ON TAXATION, PHILADELPHIA BAR ASSOCIATION

My name is Mervin M. Wilf and I appear as the chairman of the Section on Taxation of the Philadelphia Bar Association to present the Section's views regarding the budget for the Internal Revenue Service for the next fiscal year.

I previously had the pleasure of appearing before this Committee at its Hearing on March 5, 1985 in connection with the Committee's review of the so-called "Philadelphia Story." That previous testimony related to problems—human and computer—which the Philadelphia Bar Association's Section on Taxation, acting through its Council, wanted to bring to this Committee's attention. I am not here today to repeat or amplify the type of "horror stories" which were dealt with at that prior Hearing. The purpose today, rather, is to deal with some positive suggestions for solutions relating to the problems previously discussed.

Specifically, the Section on Taxation of the Philadelphia Bar Association is here today to urge increased appropriations by the Congress for improved and expanded "taxpayer procedural assistance" by the Internal Revenue Service. What we mean by "taxpayer procedural assistance" is the function of IRS personnel in providing help to taxpayers and in answering taxpayer questions about procedural matters, as distinguished from substantive issues, such as:

1. The failure of the computer to record properly taxpayer payments; the continuing improper computer-generated notices, threatening and/or imposing liens on taxpayers property when payments have already been made;
2. The repeated demands by the computer, or by humans, of information from taxpayers when that information has already been furnished to the IRS;
3. Erroneous computer-generated notices regarding late filing of returns or payments, and penalties and interest thereon, particularly when the IRS acknowledges its errors and when evidence has been presented to the IRS of timely filed payments and returns; and
4. Refusal by Revenue Officers to accept proof (e.g., cancelled checks) of payment of taxes when they are attempting to collect taxes which computer- or human-generated notices, nonetheless, show as being unpaid.

The foregoing illustrations are just that—illustrations. They do represent, however, the most frequent types of complaints brought to our attention and disclosed at the previous Hearings before this Committee and before the Oversight Subcommittee of the Senate Finance Committee.

These are strictly procedural matters. They do not involve the determination of any matter of substance regarding a taxpayer's liability. In other words, the assistance that we are addressing here does not include the determination of the correctness or incorrectness of an audit or any issue related to an audit. This is not to say that additional taxpayer assistance should not be developed for audit-related activities. It is merely to point out that our concern is for taxpayer assistance at the purely procedural level—for it was the inability of the IRS to function properly at this level which aroused most of the taxpayer anger and animosity towards the IRS which has been so well publicized in recent months.

We believe that substantial improved and additional taxpayer procedural assistance is needed for the following reasons:

1. Simply to help taxpayers—a goal in itself;
2. Improvement in handling taxpayer complaints will engender a more cooperative attitude of the taxpaying public to our voluntary assessment system; and
3. The improvement in our voluntary assessment system will, in turn, mean the collection of additional taxes irrespective of the audit functions.

In summary, we strongly believe that funds spent for substantial additional taxpayer procedural assistance will produce a greater respect by taxpayers for the Internal Revenue Service, will reduce taxpayer frustrations and anger at the IRS and will produce more money in the collection process.

Our specific proposals are as follows:

Additional funds for additional problems resolution office personnel

Several years ago, the IRS introduced the Problems Resolution Office at the District Director level. It has been our experience that the Problem Resolution Officers have provided a welcome and needed service to the taxpaying public, whether directly or through practitioners. The reports that we get from our members are that the Problem Resolution Officers really try to be helpful, are exceedingly courteous and take their responsibilities on behalf of taxpayers very seriously. The only problem is, we don't have enough of them. It has been the experience of many of our members that it is difficult to reach the PRO office because of too few telephone lines.

It has also been our experience that the public, generally, does not know of the existence of the PRO officers, although their existence is no secret. The publicity given to the PRO staff should, then, be increased, so that more taxpayers will become aware of its existence. Of course, the public must be educated that the PRO staff can be helpful only in procedural matters and cannot become involved in the determination, for example, of whether a deduction should be allowed or whether an item qualifies for capital gain treatment.

Stopping the computer

We all continue to hear stories of how the computer keeps generating notices, even though information requested in prior notices has already been sent to the Service. Steps must be taken to assure (a) that taxpayer replies to computer-generated notices are entered into the computer within a very short period of time after receipt by the IRS, and (b) that, once a taxpayer response has been entered, the computer-generated notices will automatically stop unless and until the computer is restarted by an authorized human.

It has been our experience that too many IRS people have told us that they do not have the authority to stop the computer. We have no reason to doubt that that is true. What is needed, therefore, are additional personnel with authorization to turn off the computer for good reason. Whether these personnel should be the PRO staff or others, we are not able to make a judgment based upon our present knowledge. But, we do know that something must be done to humanize the computer, because it is the computer which is dehumanizing too many taxpayers.

Staying the Revenue (Collection) Officer

Shortly after the March 5, 1985 Hearing before this Committee, it was reported that Commissioner Egger instituted a new policy of not sending out a notice of levy until the taxpayer had been personally notified by a telephone call that such action would be taken unless other arrangements were made. We welcome Commissioner Egger's decision to bring the personal touch into the levy process. However, we believe that this must be supplemented by restricting the authority of Revenue Officers to demand instant payment—or to proceed with levying or padlocking—when the taxpayer presents proof (e.g., cancelled checks) of payment of the very tax sought to be collected by the Revenue Officer. This is a complaint which was heard repeatedly at the recent Hearings.

A Revenue Officer must be instructed not to proceed with his or her collection duties if a taxpayer presents what appears to be proof of payment. In such circumstances, the Revenue Officer must terminate the collection process and tell the taxpayer to notify the other IRS personnel—presumably, the PRO staff—to get the matter clarified.

Telephone assistance

Computer-generated notices usually provide a telephone number to call for response or for further information. A too common occurrence, reported in the recent Hearings, is that number will be busy literally for hours. What is needed is easy to see—more telephones and more staff to answer the telephones. There is nothing quite so frustrating and anger-producing than to be told to call a number and then to wear out one's index finger trying to get something other than a busy signal at the other end. Even when phones get answered, it is very common to be put on "hold" for long periods of time.

CONCLUSION

We are certain that there are numerous other suggestions—excellent suggestions—to aid taxpayers in dealing with the IRS regarding procedural difficulties. We are confident that taxpayers and practitioner groups will be happy to supply other suggestions to accomplish the purposes described above. We read the newspapers. We know the pressure of the budget and the deficit. We know about the freeze imposed on personnel of all Government agencies.

However, whatever the merits of a hiring freeze, we believe that it does not make good sense to apply a freeze to the moneyraising activities of Government. There has been testimony about how the audit function will raise \$3 or \$4 for each dollar invested in additional personnel. We support additional funds for that purpose. We also urge additional funds to aid and placate the procedural problems of taxpayers, for that action, too, will provide additional revenues, as well as enhance the effectiveness of our voluntary compliance system.

Thank you for the opportunity of making this presentation.

STATEMENT OF AL JAMES GOLATO, CORPORATE DIRECTOR OF PUBLIC AFFAIRS, H&R BLOCK, INC.

Mr. GOLATO. First of all let me say I agree wholeheartedly with what Mr. Wilf just stated. As a matter of fact, in my prepared statement, which I have submitted for the record, I cover a great deal of that, but I will avoid repetition in my oral comments and just highlight certain items.

First of all, H&R Block last year employed over 45,000 men and women who prepared nearly 9 million income tax returns in over 8,000 offices in their respective communities. This represents almost 10 percent of the tax returns received by the Internal Revenue Service.

I give you this brief background to show the extent of our involvement with the tax laws and their administration by the Internal Revenue Service and with the large number of our country's taxpayers.

Because of our close association with so many taxpayers not only in preparing their tax returns but in their followup contacts with the Internal Revenue Service, we have a good idea about their views on taxes and administration, especially for lower to middle income taxpayers.

Mr. Chairman, whenever we discuss the Internal Revenue Service and its impact on taxpayers, it is as important to get the views of people who deal with the masses of middle income taxpayers as it is from those who concentrate exclusively on very small numbers but highly sophisticated issues, because they are the people that

represent your constituencies in numbers, and those views are what I hope to be able to present here.

By the way, I am not here in response to that recent cartoon in the Philadelphia Inquirer that many of you may have seen which was reprinted in the Washington Post. It showed the Internal Revenue Service in total disarray and someone on the telephone calling H&R Block for help. But we are pleased, of course, that cartoonist thought that was the public perception of our company.

First of all, we find that the Internal Revenue Service is a very professional Government agency which, under budgetary constraints does an extremely difficult, distasteful and sensitive job very well. Oftentimes, especially at times in periods like this, it gets hit pretty hard, and we fail to give them the favorable recognition they deserve.

Our tax preparers out in the field, these 45,000 people who deal year after year with the Internal Revenue Service, find them competent, considerate and fair. Sure, we have problems.

Those we have encountered in most instances could have been eliminated with more resources in special areas which I will highlight. And by no means, do we think that those problems that we have had are symptomatic of an IRS ripe with problems as some unfortunate recent incidents might indicate. I think it is important to put this in proper perspective.

We think the resources allocated to the Internal Revenue Service in the recent past were insufficient and its request for the fiscal year 1986 are inadequate for some operations.

You all know the story about audit. I am not going to go into great deal except to say that less than 20 years ago the IRS audited about 1 out of 20 tax returns or close to five times what it does now, and we suspect that there is a correlation between the well-known and highly publicized multibillion dollar compliance gap and the progressive decrease in tax audits.

I know that the IRS has become more sophisticated in selecting returns for audit, but even with that better targeting, increasing the total number of returns audited should bring in, as we all know, over \$10 in additional taxes for every \$1 spent on auditing, and I cannot think of a better way to solve some of our current financial problems.

The problem in the Philadelphia Service Center is illustrative of the Internal Revenue Service's need for additional personnel to deal with taxpayer's refunds, adjustments, and tax account problems which occur after the tax returns have been filed.

Most people understand that problems will occur in the system which processes vast amounts of paper by computer technology, but it is too much to expect taxpayers to tolerate an inadequate number of competent and compassionate human beings for them to contact for an immediate resolution of their problems.

We are concerned that because of the difficulty of making personal contacts with IRS people, some taxpayers may choose to pay erroneous billings rather than bothering to struggle to get through the inadequate points of human contact, and their perception of the IRS and our tax system gets progressively worse.

The IRS wants to reduce a substantial number of positions due to improved productivity from automation. We think the savings

ought to be shifted to adjustment personnel and others who will be available to answer taxpayer correspondence, handle taxpayer refunds, billing and other taxpayer accounts and processing and procedural problems like the recent computer foulup.

Last summer the Internal Revenue Service issued nationwide a large number of notices incorrectly informing taxpayers that they owed penalties for underestimating quarterly income tax payments. Our offices were deluged with taxpayers, both our clients and others, for assistance and advice.

I contacted the IRS in Washington. The IRS agreed to notify taxpayers through press releases from Washington and its field offices. We also felt compelled to contact many thousands of our clients individually at considerable expense when the IRS told us that they did not have adequate funds to go through the process of identifying and sending correction notices to the taxpayers who received erroneous bills.

This incident also caused us client relations problems because many of them thought that we made the error in preparing their tax returns.

This incident illustrates the need for the Internal Revenue Service to have additional funds and human resources to correct its own after-filing problems rather than having to rely on taxpayers who had already done their job right in the first place.

We also think you should consider suggesting a contingency fund in the Internal Revenue Service budget for correcting problems involving large numbers of taxpayers by massive mailings of individual notices like the one that occurred and impacted on us so much. The Internal Revenue Service said they could not do it because they did not have the money.

To help cut Internal Revenue Service's expenses without burdening many taxpayers, we agree with the administration proposal that the Internal Revenue Service should impose user fees for private letter rulings. This would help control the Internal Revenue Service workload in this highly specialized program and it would help fund this area of its operations which is mostly servicing a relatively few high income taxpayers.

Another area where we think the Internal Revenue Service costs can be reduced is in its printing, packaging and mailing of its millions of tax forms and booklets to taxpayers who do not want or need to receive them since they use tax professionals to prepare their tax returns.

The Internal Revenue Service after numerous suggestions decided to test the idea in 1983. Instead of the usual tax packages, postcards with removable address labels were mailed to 618,000 taxpayers who had their tax returns done by tax preparers the previous year.

The Internal Revenue Service saved \$150,000 in that very small test. The Internal Revenue Service expanded the test this year but we are not aware some of the results. We think this idea has potential for much greater savings.

All that we have heard here today is increase the cost, increase the staff, increase the efforts and the resources. The fact remains that you have some suggestions that I am presenting where IRS could decrease costs and use the savings in the areas that we and

some of the people who testified here today feel should be beefed up.

The Internal Revenue Service is subjected to frequent criticism. It is sometimes accused of being too vigorous in its enforcement work. At other times there are charges that it does not do enough to improve compliance. Yet the Internal Revenue Service is so respected for its management efficiency and integrity, that it is assigned programs such as collecting various non-tax debts owed to the Federal Government and pressured to enforce non-tax criminal laws. It seems reasonable to us to have the Internal Revenue Service concentrate its limited resources and efforts on what it does best and what only it can do.

There's no need to go through all of them, but answering taxpayer correspondence, receiving and efficiently processing tax returns, quickly issuing tax refunds or bills, maintaining accurate accounts for each taxpayer, making account adjustments, and correcting errors as soon as possible, auditing more tax returns, investigating criminal tax violations, and extensively publicizing them so that you have a deterrence effect are the things only it can do. To ask the Internal Revenue Service to do any more only makes their job too much to handle. And frankly, that is the position I think that the Internal Revenue Service finds itself in today.

Taxpayer assistance efforts should be concentrated in furnishing those services that can only be provided by the Internal Revenue Service and which cause so much public frustration such as the after-filing, account and processing items referred to earlier and to which Mr. Wilf referred to rather extensively. Substantive taxpayer assistance—helping taxpayers with filing their tax returns—can and is performed to a great extent by the private sector. Public policy reflected in the Internal Revenue Code for many years encourages the use of paid tax preparation assistance by granting a deduction for the fees paid by taxpayers who itemize deductions. You are all aware of that. However, a similar tax assistance benefit is not available to those who do not itemize deductions—usually lower income taxpayers and those who are least able to understand the tax laws. Millions of our low income clients view this as a glaring inequity.

A fair solution to this inequity and the taxpayer assistance problems annually confronting the Internal Revenue Service and this committee, one that recognizes the Government's responsibility to all taxpayers to meet their tax filing responsibility is to grant some similar tax relief for tax preparation expenses to non-itemizing taxpayers so that they would have the same help in seeking reliable professional tax assistance as the law already grants to those who itemize. Without going into detail, there is a bill that has been presented by one of your colleagues, H.R. 1608, which does just that.

Passing H.R. 1608 would be a good way to assure that adequate substantive taxpayer assistance is available to all taxpayers at relatively little cost, all of which would probably be recovered with the filing of more accurate tax returns and reduced IRS expenditures—and with no increase in taxpayer assistance staffing.

This concludes my prepared testimony, Mr. Chairman. I will be pleased to answer any questions.

[The prepared statement follows:]

STATEMENT OF AL JAMES GOLATO, CORPORATE DIRECTOR OF PUBLIC AFFAIRS, H&R BLOCK, INC.

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before this subcommittee to comment on the proposed Internal Revenue Service's budget for fiscal year 1986.

H&R Block last year employed over 45,000 men and women who prepared nearly nine million income tax returns in over 8,000 offices in their respective communities throughout the United States. This represents almost 10 percent of the individual income tax returns filed with the Internal Revenue Service.

I give you this brief background to show the extent of our involvement with our tax laws and their administration and with the large number of our country's taxpayers. Aside from the Internal Revenue Service, we deal with more federal income taxpayers than any organization or individual. Because of our close association with so many taxpayers—not only in preparing their tax returns but in their follow-up contacts with the Internal Revenue Service—we have a good idea about their views on taxes and tax administration. Few, if any, individuals or organizations are in such a unique position to learn and understand the tax problems of so many people, especially lower to middle income taxpayers.

These lower to middle income taxpayers have no formal or recognized tax lobbyist or advocate to advance their causes, protect their interests and represent their views. Because of our intimate tax relations with so many of these taxpayers, we are probably the next best source to articulate their views.

By the way, we are not here in response to that recent cartoon in the *Philadelphia Inquirer* and reprinted in the *Washington Post*, which showed the IRS in total disarray and desperately calling H&R Block for help. Although, I must admit, we do appreciate the public perception of our company the cartoon projects.

I do not intend to comment specifically on line items in the IRS budget. Rather, I want to call your attention to specific IRS problems that need attention and some of its operations that in our view require special resource allocation.

But first, something that I feel compelled to say about IRS generally: We find the IRS to be a very professional government agency which, under budgetary constraints does an extremely difficult, distasteful and sensitive job very well. Our tax preparers who deal with IRS people in the field find them competent, considerate and fair. This does not mean, however, that we have not had problems. Those we have encountered could have been largely eliminated with more resources. And by no means do we think they are symptomatic of an IRS rife with problems as some unfortunate hyped-up publicity would indicate.

We think the resources allocated to the IRS in the recent past were insufficient and its request for the fiscal year 1986 are inadequate for some operations which I shall identify.

Audit coverage, as almost everyone knows, has declined considerably. Although the exact figures vary somewhat, depending on the source of the information and the class of the tax return, most data indicates that today only a little over one of 100 tax returns is audited. Less than 20 years ago the IRS audited about one out of 20 tax returns or close to five times what it does now. We suspect that there is a correlation between the well-known and highly-publicized multi-billion dollar compliance gaps and the progressive decrease in tax audits. I know the IRS has become more sophisticated in selecting returns for audit but even with the better targeting, increasing the total number of returns audited should bring in over \$10 in additional taxes for every \$1 spent on auditing. I can't think of a better way to help with our budget deficit while at the same time assuring the public that tax cheaters are not going to easily dump their share of taxes on the shoulders of honest taxpayers.

The Internal Revenue Service has recommended that 2,500 additional auditors be hired each year for three years starting October 1985. But the administration, in its efforts to freeze federal spending this budget year, has proposed to defer the hiring on the initial 2,500 new auditors until the end of fiscal year 1986. We think that is too short-sighted and not in the best interest of quickly reducing the federal deficit and increasing public confidence that all taxpayers are paying their fair share. We recommend that you urge the House Appropriations Committee to allocate funds for earlier recruitment and training of the new IRS auditors.

Much of the bad publicity about computer errors recently received by the IRS was probably due to an anecdotal highlighting of an isolated incident at the Philadelphia Service Center which happened close to the April 15 tax deadline when tax news is on the media's front burner. However, the incident itself, which I shall not dwell on here, is illustrative of the IRS need for additional personnel to deal with taxpayers' refunds, adjustments and tax account problems after their tax returns have been

filed. Most people understand that problems will occur in a system which processes vast amounts of paper by new computer technology. But it is too much to expect taxpayers to tolerate an inadequate number of competent and compassionate human beings for them to contact for an immediate resolution of their problem or some reassurance that they will soon be resolved.

We are concerned that because of the difficulty of making personal contacts with IRS people, some taxpayers may choose to pay on erroneous billings rather than bothering to struggle to get through the inadequate points of human contact. And their perception of the IRS and our tax system gets progressively worse.

The IRS wants to reduce returns processing funds by \$14.6 million through the elimination of 698 positions due to improved productivity from automation. We think the savings ought to be shifted to adjustment personnel and others who will be available to handle taxpayer refund, billing and other taxpayer account and processing problems like the recent computer foul-up and the next one I will cover.

Last summer, the Internal Revenue Service issued nationwide a large number of notices incorrectly informing taxpayers that they owed penalties for underestimating quarterly income tax payments. The problem was caused by the IRS ignoring the receipt of Form 2210 with the tax return which included the reasons penalties should not have been asserted. Our offices were deluged with taxpayers, both our clients and others, for assistance and advice. In almost every case, the IRS notices were in error.

I contacted the IRS in Washington to explore methods for resolving the massive error. IRS agreed to notify taxpayers through press releases issued from Washington and its field offices. We also felt compelled to issue a press release of our own and to contact many thousands of our clients individually, at considerable expense, when IRS told us they did not have adequate funds to go through the process of identifying and sending correction notices to the taxpayers who received erroneous bills. This incident also caused us a client relations problem because many of them thought we made the error in preparing their returns. Some may have lost confidence in us and some expressed concern that their returns would be subjected to closer scrutiny by the IRS in the future. For each of the erroneous notices, back-up materials had to be sent to the IRS to correct the situation . . . and often we or individual taxpayers were unable to reach IRS personnel for specific assistance.

This incident, illustrates the need for the IRS to have additional funds and human resources to correct its own after-filing problems rather than having to rely on taxpayers who had already done their job right. We also think you should consider suggesting a contingency fund in the IRS budget for correcting problems involving large numbers of taxpayers by massive mailings of individual notices.

To help cut IRS expenses without burdening many taxpayers, we agree with the Administration proposal that the IRS should impose user fees for private letter rulings. This would help control the IRS work load in this highly specialized program and help fund this area of its operations which is mostly servicing a relatively few higher/income taxpayers. This work requires relatively high paid IRS tax experts to do extensive and sophisticated legal-type tax research and technical writing most often for businesses that can afford it or tax practitioners who can then charge fees for it.

Another area where we think IRS costs can be reduced is in its printing, packaging and mailing of its millions of tax forms and booklets to taxpayers who do not want or need to receive them since they use tax professionals to prepare their tax returns. Most accounting and legal forms and other large tax preparing firms make no use of the forms and booklets mailed to their clients.

If the idea were adopted by the Internal Revenue Service, in addition to the printing and postage savings, it would also reduce the useless paper received by people and conserve raw materials used to produce paper—certainly objectives worth seeking for the public interest.

When we first made this suggestion to the Internal Revenue Service, it was rejected because the mailed packages included a pre-addressed label which helps in processing tax returns. But then we suggested substituting a pre-addressed label on a postcard. The less expensive postcard also would serve as the annual IRS "presence" or "reminder" to taxpayers.

Another argument previously made by IRS was that if it stopped mailing the tax packages to taxpayers, it would be faced with the prospect of filling millions of individual orders by expensive special handling. Actually, if taxpayers opted not to be sent the tax packages because they customarily have their tax returns handled by paid preparers, there should be many requests for the forms from IRS. As for the paid tax preparers themselves, they either print their own forms (as we do) or they would merely continue requesting—and paying for—bulk orders as they do now.

The IRS finally decided to test the idea in 1983. Instead of the usual tax packages, postcards with removable address labels were mailed to 618,000 farmers and fishermen who had their tax returns done by tax preparers the previous year. The IRS had calculated that if less than 36 percent of these requested tax forms and booklets—they had that option with the postcard—the program would result in savings for IRS. Only 4.3 percent actually requested the tax packages and the IRS saved \$150,000 in that very small test. The IRS expanded the test this past year. Results are not yet in. But we think this idea has potential for much greater savings and we request that you give some time to overseeing this program.

The Internal Revenue Service is subjected to frequent congressional and public criticism; it is sometimes accused of being too vigorous in its enforcement work yet at other times there are charges that it does not do enough to improve compliance. Yet, the IRS is so respected for its management efficiency and integrity that it is assigned programs such as collecting various nontax debts owed to the Federal government and pressured to do more to enforce nontax criminal laws.

It seems reasonable to us to have the IRS concentrate its limited resources and efforts on *what it does best* and on *what only it can do*. These are: receiving and efficiently processing tax returns; quickly issuing tax refunds or bills; maintaining accurate accounts for each taxpayer; making account adjustments and correcting errors as soon as possible; collecting delinquent taxes; auditing more tax returns that it does now; investigating criminal tax violations and publicizing the results for deterrence effect.

To ask the IRS to do much more only makes the total job too much to handle.

Taxpayer assistance efforts should be concentrated in furnishing those services that can only be provided by the IRS and which cause so much public frustration such as the after-filing account and processing items referred to earlier.

Substantive taxpayer assistance—helping taxpayers with filing their tax returns—can and is performed to a great extent by the private sector, probably with more taxpayer satisfaction and reliance. Close to 40 percent of tax returns are now completed by paid preparers. Public policy reflected in the Internal Revenue Code for many years encourages the use of paid tax preparation assistance by granting a deduction for the fees paid by taxpayers who itemize deduction. However a similar tax assistance benefit is not available to those who do not itemize deductions—usually lower income taxpayers and those who are at least able to understand the tax laws. Millions of our lower-income clients view this as a glaring inequity.

A fair solution to this inequity and the taxpayer assistance problems annually confronting the IRS—one that recognizes the government's responsibility to help *all* taxpayers meet their tax filing responsibility—is to grant some similar tax relief for tax preparation expenses to non-itemizing taxpayers so that they will have the same help in seeking reliable professional tax assistance as the tax law already grants to those who itemize.

We note that a bill, H.R. 1608, has been introduced by one of your colleagues, which would provide a credit for tax preparation fees for non itemizers, up to \$15, which would assist them too in securing professional tax assistance. A similar bill was introduced last year by five of your colleagues.

Some will say what we need is real tax simplification. But tax simplification may not be that simple when and if it is passed. Or you may decide to pass a minimum tax law that would rebuild public confidence in our tax system by preventing big corporations and wealthy individuals from avoiding taxes. In either case, taxpayers will still need tax assistance. But regardless of what may happen in the future, in the meantime, why not eliminate the tax assistance inequity that exists among classes of taxpayers, ease the taxpayer's burden of complying with the still-existing tax system, enable the IRS to receive more correct tax returns and reduce IRS costs and administrative problems? Passing H.R. 1608 may be a good way to assure that adequate substantive taxpayer assistance is available to all taxpayers at relatively little cost—all of which will probably be recovered through the filing of more accurate tax returns and reduced IRS expenditure. And the IRS's taxpayer assistance program will no longer be an annual controversy.

This concludes my prepared testimony, Mr. Chairman. I will be pleased to try and answer any questions you or the Members of the Subcommittee may have.

Chairman PICKLE. Well, Mr. Golato, I am going to pass your statement on to the Internal Revenue Service. You have got a lot of suggestions that both this committee and the IRS might well take into consideration.

Who is the author of the bill 1608?

Mr. GOLATO. Who introduced it, did you say?

Chairman PICKLE. Yes; who is the author?

Mr. GOLATO. Representative Campbell, Carroll Campbell.

Chairman PICKLE. Campbell?

Mr. GOLATO. Campbell.

Chairman PICKLE. Carroll Campbell?

Mr. GOLATO. Yes.

Chairman PICKLE. All right. Well, you may be correct. If we could stop a lot of the weaknesses and deficiencies of the system, you might make enough to offset the request you normally make for additional personnel.

Mr. Wilf, I like your four suggestions; at least you are accentuating the positive and you try to eliminate the negative.

Mr. WILF. Thank you, Mr. Chairman.

Chairman PICKLE. You give four areas of corrections, all positive, that we ought to take into consideration. I wish we had had you at the beginning of the hearing today. It might have put us in a more positive frame of mind. But we are going to pass these along. I do not know how you would stop the computer or you would stay the collector, but there are ways to get at this, I am sure. Certainly it should be so as is to the collector so that taxpayers do not get a phone call as Mr. Egger has suggested first, in addition to the notice. So I think these four parts are well taken, and I am glad to have them.

Mr. WILF. Thank you, Mr. Chairman.

Chairman PICKLE. They are general in nature. I do not think that is going to stop the adding of personnel as our responsibilities grow and as the population grow and more returns are being processed. We may well have to go to additional personnel.

Mr. WILF. I think you probably will for this. I do not think the people are out there really trying to help taxpayers on procedural matters. That has not been the emphasis.

Chairman PICKLE. Well, now, let me ask you on a more local basis. Do you think that the problem in the Philadelphia office has subsided? Is it better than it was? Do you think that the extra personnel they put in there or the emphasis they put on the collections have improved the situation?

Mr. WILF. From what little I have seen personally, the answer is no. I must again make a distinction between the service center and the district director's office. The problems in our area, I think, are almost exclusively at the service center. Our relations with the district director's office are quite different. We can talk to people eventually, but the problem still is the computer generated notices which were inaccurate. We just had one of our officers get a notice which was totally inaccurate, and after his going through individuals to get there and the computer itself is wrong, it is that frustrating computer where the delay in recording correspondence causes the computer to be inaccurate and IRS personnel just cannot seem to stop it. And that is really where the problem comes in. The publicity given to the Philadelphia situation is the delay in refunds, which, I understand, is a national situation. And other than that I do not think there is any real difference in Philadelphia that I know about, Mr. Chairman.

Chairman PICKLE. Well, Mr. Golato, do you say that the taxpayers services are a vital segment to increase and to augment in the IRS centers? Is that helpful to the average taxpayer?

Mr. GOLATO. I have solicited our people, and as a result of what has occurred, this year, we had a large number of problems in trying to get through to correct some of the errors. Some of it was nothing more than paranoia. They read about the computer problem in the newspapers and they were concerned about their tax returns. They come back to our company, and our people try to make contacts; they cannot get through. It is that type of after-filing taxpayer service that I feel has to be concentrated on. That is what causes the frustration.

Chairman PICKLE. And the Austin Internal Revenue Center, the district office we visited there a couple of weeks ago, and the taxpayer services were busy, they were courteous, and they were efficient and, I think, were extremely helpful to individuals who came to that office. And I would hope we could improve that type of a service.

Mr. McGrath.

Mr. McGRATH. Thank you, Mr. Chairman.

Mr. Golato, I have a next-door neighbor who is an accountant, and he told me not to think about passing another tax bill until we got the regulations and rules down for the 1969 bill. Do you find that a problem, the promulgating of rules and regulations on the tax bills that have come up?

Mr. GOLATO. Yes, sir, Mr. McGrath. I do. We find it difficult because of the lack of rules and regulations. But I want to make a distinction here which relates to what I had said earlier, Mr. McGrath. The problem is with the hold up of published regulations and published rulings that everyone relies on. But the Internal Revenue Service puts out private rulings to individuals and businesses that cannot be used to rely on; it is strictly taxpayer assistance for the well-to-do, where you use some of the most highly sophisticated and technical tax experts to do it. And it seems to me that if we have to recoup some costs for the Internal Revenue Service to redirect elsewhere, this is the place to do it, through user fees.

Mr. WILF. May I just dissent, Mr. Chairman, from what Mr. Golato said because these private letter rulings he refers to are submitted, but they are often the subject of future published rulings. In fact, you will see published rulings almost following word for word the concepts in the private rulings. And, if you are drawing up the private rulings, you are drawing a very important pipeline to tax policy. This is where policy and implementing policy is being made.

Now, I am not for or against user-payor kind of system, necessarily. But to indicate that these private rulings are just for the benefit of the wealthier taxpayer is not an accurate statement, in my opinion.

Mr. McGRATH. One further question. Does H&R Block support the Treasury proposal?

Mr. GOLATO. Support the Treasury proposal?

Mr. McGRATH. Tax reform proposal.

Mr. GOLATO. Oh, you mean for tax reform? We have not taken a formal position either for or against it, but we certainly would not hesitate, and we have not, including our president down to myself, to highlight some of the potentially negative consequences of some of its provisions.

Mr. McGRATH. I would be interested to hear from persons who fill out 9 million returns a year as to what they think what form a tax simplification plan should take.

Mr. GOLATO. Well, tax simplification, the purest sense of tax simplification is not passing annual changes in the tax law or, something that will never pass the Congress, because it would be too unfair, and that is a pure flat tax. But I don't think that is what has been proposed right now, one of the things that would interest you particularly is the proposed elimination of the deduction for State and local taxes. That, for instance, causes negative consequences.

Chairman PICKLE. Do you gentlemen approve or disapprove of the budget that the OMB and the IRS has now agreed on? Are you familiar with the figures on both personnel and the various agents of the sector? Mr. Wilf, are you—

Mr. WILF. Yes. I have seen them and looked at them. I am not an expert on budgets, Mr. Chairman. It just seems to me that if the administration takes the position that extra people in fiscal year 1987 will produce more income for the Government, then I do not understand why they do not implement that position in fiscal 1986. It defies my sense of logic. If there may be logic there somewhere, it escapes me. If it is good for 1987 to raise \$4 or \$5 billion, what is wrong with 1986? Whether or not you need additional personnel in other areas, the areas that I spoke about, I think the answer is clearly yes; whether they can be transferred from another area, I do not know.

Chairman PICKLE. Mr. Golato.

Mr. GOLATO. Mr. Chairman, yes. I agree 100 percent, that if the Internal Revenue Service is going to pick up 2,500 more auditors and for the first year they want to pick them up at the end of the year, I think that is shortsighted. I think they ought to pick them up at the beginning of the year so that they could start immediately rebuilding public confidence in the tax system and getting that additional income that we all know they will. Second, there is in the returns processing part of the budget one item which would eliminate 698 positions due to improved productivity because of automation. It seems to me that if there is that type of reduction, it ought to be reapplied immediately to those problems that both Mr. Wilf and I alluded to, which are the after filing tax problems that cause so much frustration. Either in the ombudsman area, the problem resolution, or any of the adjustment areas at the service centers.

Chairman PICKLE. I thank you, and I thank both you gentlemen for your testimony. You have been very helpful to us and we appreciate your coming forth and being so patient. Again, Mr. Wilf, particularly, we do not know if we will have a hearing here again, but we are going to have additional hearings in the field and offices. The committee is going to keep a continual oversight on this subject throughout the rest of this year. We appreciate the testimony

you both have given, and I appreciate the attendance of the members of the committee here today.

That completes the hearing on this particular subject, and the committee now will stand adjourned.

[Whereupon, at 3:58 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
Washington, DC, May 17, 1985.

Hon. EDWARD R. ROYBAL,
Chairman, Subcommittee on Treasury, Postal Service and General Government, Committee on Appropriations, Washington, DC.

DEAR MR. CHAIRMAN: We are writing to you regarding a matter of great mutual interest and concern: the adequacy of the Internal Revenue Service's staffing and funding levels as proposed in the Administration's budget request for fiscal year 1986. We strongly recommend that the FY 1986 Internal Revenue Service appropriations now under consideration by your Subcommittee be increased by \$115.6 million, \$50 million of which would be used to guarantee upgrading IRS's computer capacity to meet next year's filing season workload and \$65.6 million of which would be used for necessary staffing (1,500 more than that requested in the Administration's FY 1986 Budget).

The recommendation is made by us on a bipartisan basis as the Chairman of the Committee on Ways and Means, the Chairman of the Subcommittee on Oversight, and the Ranking Minority Member of the Subcommittee on Oversight. We feel very strongly that our recommendation continues to be supported on a bipartisan basis by both the Appropriations and Budget Committees, and on the House floor. In the event that this recommendation becomes a political issue, we are prepared to merely go along with the Administration's request and allow the IRS to be cut back to below 1980 levels. Such a turn of events would be unfortunate and would undoubtedly have an adverse effect on taxpayers nationwide. We hope this letter represents the beginning of a truly bipartisan effort that will reach to the floor of the House itself.

We are convinced that our recommendation, which is based upon information furnished to us by IRS itself, is critically needed, realistic, and modest in cost when compared to the high revenue yield. Because of the nature of our voluntary tax compliance system, the resources that are necessary to permit the Internal Revenue Service to accurately process taxpayers' accounts and correspondence in a prompt and professional manner, also have the effect of building taxpayers' confidence in the tax system and improving voluntary compliance. Further, under our proposal, for each additional dollar spent for IRS, IRS would return approximately \$5 to the U.S. Treasury in fiscal year 1986 alone.

This recommendation is the outgrowth of the Oversight Subcommittee's April 29, 1985, hearing on the proposed FY 1986 budget for IRS. As you know, the IRS budget as submitted to the Congress provides for 86,489 positions and \$3.5 billion to administer this Nation's tax laws, a decrease of 1,254 positions and \$30.4 million from FY 1985 levels. The purpose of our hearing was to assess the effect of the proposed staffing levels and allocation of resources for IRS on fair and efficient tax administration, voluntary compliance, and the collection of Federal revenues.

Every witness at this Oversight Subcommittee hearing, including—albeit reluctantly—the Internal Revenue Service, testified that increased IRS staffing over the levels proposed is needed. Information presented by the witnesses, statements and data included in the IRS FY 1986 Budget Submission to the Congress, and background budget documents, all demonstrate that at the proposed resource levels, IRS will not be able to keep pace with its obligations in FY 1986. This means that IRS will not have the resources that will enable it to efficiently assess and collect taxes legally due and owing the Federal Government, nor provide taxpayers with prompt and meaningful services, nor, in the final analysis, to maintain and promote voluntary compliance.

Certainly the facts speak for themselves. At the proposed budget levels, IRS will have fewer staff than it had in 1980, even though, since 1980,

- the taxpayer population has grown significantly each year (it is estimated that 5 million additional returns will be filed in FY 1986 than is projected for 1985);
- that tax gap (i.e., the difference between the amount of tax liability reported and the amount that should have been reported by those taxpayers filing tax

- returns) has continued to widen: at \$62 billion in FY 1980, IRS now projects that the tax gap will total \$92 billion in FY 1986;
- voluntary compliance has continued to decline from 84 percent in 1974 and 82.1 percent in 1980, down to 81.6 percent projected by IRS for FY 1986 (IRS estimates that each additional 1 percent of voluntary compliance in FY 1986 would raise about \$5.6 billion in revenues); and
- the passage of three major tax bills has dramatically increased IRS's workload far beyond its staffing levels.

Yet, the proposed FY 1986 IRS budget will require that IRS confront these critical developments with less service to fewer taxpayers; decreased examination coverage; high backlogs in inventories of uncollected, unpaid accounts and delinquent return investigations; and less staff to meet new, additional responsibilities, like administering the Deficit Reduction Act of 1984 (P.L. 98-369).

There is little question that our recommended staffing level will promote a fairer administration of the tax law and help close the deficit. After all, IRS is the primary revenue producing arm of the Federal Government, collecting about 90 percent of all Federal receipts. Each tax dollar collected by IRS directly increases revenues going into the U.S. Treasury, and thereby reduces the Federal deficit. Therefore, any funding level which restricts IRS's capacity to assess and collect taxes directly translates into less money flowing into the Treasury. Surely the cost to the Treasury in terms of known lost revenues will far exceed any short-term savings that could possibly be attained through limiting Federal employment and expenditures regarding IRS, as proposed under the FY 1986 budget.

The effect that an inadequately staffed and funded IRS has on taxpayers and indeed on our very system of voluntary compliance cannot be overstated. We need only to witness this year's recent events. Problems in Service Centers, particularly concerning computer operations for processing tax returns, have resulted in all-time record overtime, delays in issuing refunds, other work—such as taxpayer correspondence—in order to just process the returns being filed, and evidence of destruction or mishandling of documents. There are just too few trained personnel to handle the workload. The progress of the computer modernization and the productivity savings that can be attributed to it are questionable at this point. Taxpayers, already well-aware of the audit lottery that permits many nonpaying taxpayers to escape paying their fair share, are confronted with a less than efficient, less than well-functioning IRS. All too often, they cannot get answers to their questions, or responses to their cases in the adjustments and correspondence branch (nationwide inventory stood at 774,355 on March 29, 1985), or even their refunds within a period that they once could rely upon. Taxpayers can no longer count on receiving the high-level of service from IRS they have come to expect. A well-run, fine-tuned, responsive IRS is the foundation of our voluntary compliance system. Let us make sure that that foundation is firm.

It is for all of these reasons, confirmed by every witness at our April 29, 1985 hearing, that we present to you our recommendation for increased IRS staffing and funding in FY 1986. The Subcommittee requested and received information from IRS on the operational, revenue and cost impacts of both personnel gains by staff-year increments and certain funding increases. Copies of these responses from IRS are provided for your deliberation. This information forms the very basis of our recommendation, which is now described in detail below:

Recommendation.—(A) That the FY 1986 IRS Budget Request be increased by \$65.6 million to provide for 1,500 additional staff.

(B) That an additional \$50 million in funding be allocated to guarantee an upgrading of computer capacity necessary to meet the demands of next year's filing season.

Yield.—IRS projects that additional revenue collected in FY 1986 would total \$531.8 million.

Allocation of 1,500 additional staff positions.—One thousand additional positions would be allocated to non-enforcement functions, primarily the principal tax processing and taxpayer service programs. Such allocation of resources to non-enforcement programs, according to IRS, increases the quality and responsiveness of Service operations and thus contributes to improved voluntary compliance. An additional 500 positions would be allocated to IRS's major enforcement programs: Examination, the Information Returns Program, and Collection. This staffing allocation is based upon our conviction that, in order for the IRS to operate efficiently and fairly, the IRS must have adequate resources to run a balanced program.

ALLOCATION BY PROGRAM OF ADDITIONAL STAFF AND REFUNDING RECOMMENDATION

Program	Additional staff	Cost (millions)	Additional revenue collected in fiscal year 1986 (millions)	Yield/cost
Return processing and taxpayer correspondence	725	\$42.0	\$250.0	6.1
Taxpayer service	125			
Appeals and tax litigation	125			
Other programs	25			
Enforcement programs	500	23.6	281.8	12.1
Subtotal	1,500	65.6	531.8	8.3
Computer modernization	N/A	50.0	N/A	N/A
Total	1,500	115.6	531.8	4.6

MAJOR PROGRAM ALLOCATION ANALYSIS

(1) *Returns processing, taxpayer correspondence.*—The majority of the 1,000 additional positions which IRS would apply to its nonenforcement programs, and which is the most crucial portion of our recommendation for increased staffing, would be used principally in the Service Centers to improve and strengthened computer operations, assure staffing levels sufficient to process expected growth in the volume of tax returns filed, and improve the timeliness and quality of taxpayer correspondence.

The Oversight Subcommittee's April 29, 1985 hearing and our earlier March 11, 1985, hearing on the tax payment posting problems in the Philadelphia Service Center, confirm the immediate need for additional resources employed for the three purposes identified above. Substantial deficiencies in these three areas have resulted in lack of responsiveness to taxpayers and even issuance of massive numbers of erroneous notices on several occasions identified so far by IRS and the General Accounting Office. It is instances such as these that shake taxpayers' very trust in our tax system. We cannot permit that to continue.

(2) *Taxpayer service and other programs.*—IRS would increase Taxpayer Service and other programs by 150 additional staff which would result in the Service's assisting 1.7 million additional taxpayers and strengthen its Problem Resolution program. Under the Administration's proposed budget, Taxpayer Service would be reduced by 156 positions from FY 1985 (or 225 positions from 1984 levels) and over 2 million fewer taxpayers (or over 4 million from 1984 levels) would be assisted. Our modest increase would begin to reverse the recent tendency in times of budget restraints to sacrifice the quantity and quality of assistance given taxpayers. Clearly more and better service is called for. Former IRS Commissioners and tax practitioners re-affirmed this need. A recent General Accounting Office study (a copy of which is attached) provides further confirmation.

We remain firm in our belief that IRS has a responsibility to promptly and adequately assist taxpayers as they try to comply with our almost constantly changing tax laws. The degree to which IRS has sufficient resources to meet this obligation has a very real impact on the level of voluntary compliance with those laws. We have a responsibility to assure that IRS meets its obligations.

(3) *Appeals and tax litigation.*—IRS would apply the final 125 positions remaining from the 6,000 additional positions to Appeals and Tax Litigation in order to close an additional 6,600 tax shelter cases which would bring in estimated revenues of \$250 million.

Under the Administration's budget proposed for FY 1986, this function would be decreased by 16 positions from 1985. However, workloads and ending inventories would continue to climb while disposals would remain rather constant. Particularly in light of future increases in workload, IRS must have the ability to work these cases through to completion. More staff appears the only sure way of guaranteeing that result.

(4) *Enforcement.*—Our proposal projects an allocation of 500 additional staff to IRS enforcement programs, which includes Examination, Information Returns Program, and Collection. This would raise an additional \$281.8 million in revenues in FY 1986 alone.

As examination coverage has declined in recent years, so has voluntary compliance. Such witnesses at the April 29, 1985, Oversight hearing as the General Accounting Office, former Commissioners Sheldon Cohen and Donald Alexander, the National Treasury Employees Union, and tax practitioners, all agreed that the examination coverage was falling to a dangerous level. Even if each examination was more productive than in earlier years, the fact remains that, in total numbers, IRS's examination or audit presence is inadequate. The "audit lottery" is still an attractive, low-risk game to play.

We should also point out that collection is clearly understaffed at a time when accounts receivable has approached a record high of \$30.1 billion, and all inventories are remaining high. A decrease of 801 positions in FY 1986, when coupled with a 2,337 reduction from FY 1984 to 1985, would virtually negate the additional Collection positions contained in the FY 1983 revenue initiative approved in the Tax Equity and Fiscal Responsibility Act of 1984—an initiative that IRS estimates will result in cumulative revenue collections of \$9.5 billion in FY 1985, of which \$6.3 billion relates to Collection efforts.

IRS allocation of an additional funding of \$50 million.—IRS's allocation of an increased funding (as separate and apart from the 1,500 additional staffing) of \$50 million over the proposed FY 1986 level, reflects the Service's priorities. A significant portion of that funding would be used to strengthen technical and computer training and to finance ADP systems improvements in the Service Centers for remittance processing, data input and upgraded computer capacity.

We believe that such strengthening of clearly apparent weaknesses in IRS's current computer system is essential in FY 1986. While we support IRS's commitment to computer systems modernization, we also are fully aware that it is not a state-of-the-art system. Nor has it been problem-free as witnessed by this year's filing season. Indeed, the extent of those problems has surprised even IRS. Furthermore, information this Subcommittee has obtained from IRS (a copy of an IRS paper entitled, "Service Center Replacement System Improvement Program," is attached for your review) indicates that additional computer capacity must be in place in at least 6 of the 10 service centers early in FY 1986 in order to handle the additional workload associated with next year's filing season.

We must do what we can to assure taxpayers that next year they will not be faced with a filing season like this year's. It seems clear to us that additional funding is the essential ingredient of that assurance. It is not a luxury we can afford to do without; it is a necessity.

We must bring one final matter to your attention. According to IRS, neither the FY 1985 budget nor the FY 1985 Supplemental anticipated the excessive costs (e.g., record overtime) that have been incurred during this year's filing season. We support your full review of this situation. Our concern is that without additional funding in FY 1986, IRS may not be able to provide staffing up to the authorized levels, and that existing problems will be further exacerbated.

In conclusion, we believe that this recommendation provides, at modest cost an immediate, high return, IRs with resources essential to do its job well. The true beneficiaries will be all law-abiding taxpayers who must now bear the additional tax burden of the noncompliance. Additional revenues also would flow directly into the U.S. Treasury, thus significantly contributing to deficit reduction efforts. This recommendation certainly is not a complete solution to the problem of years of IRS understaffing that has impeded fair and effective tax administration, but it is a vital first step. We urge its acceptance.

Sincerely yours,

DAN ROSTENKOWSKI,
Chairman.

J.J. PICKLE,
Chairman, Subcommittee on Oversight.

RICHARD T. SCHULZE,
Ranking Minority Member, Subcommittee on Oversight.

COMMITTEE ON WAYS AND MEANS,
Washington, DC, December 3, 1984.

Hon. ROSCOE L. EGGER, Jr.,
Commissioner, Internal Revenue Service, Washington, DC.

DEAR COMMISSIONER EGGER: As you know, the Committee on Ways and Means' Subcommittee on Oversight has begun a comprehensive review of the administra-

tion of the Federal tax laws by the Internal Revenue Service. As part of this study the Subcommittee is examining IRS staffing levels and allocation of resources. I am writing to request that your office respond to the following questions:

(1) How would the Service allocate additional staffing over the authorized FY 1985 levels at each of the following levels: (a) 500 additional staff; (b) 1,500 additional staff; (c) 3,500 additional staff; and (d) 5,000 additional staff? What would the yield to cost ratio be for each level?

To facilitate your efforts, let me point out that related information was submitted previously to the Subcommittee in connection with its May 11, 1981 hearing on the "Administration's Fiscal Year 1982 Budget Proposals Relating to the Internal Revenue Service", hearing record pages 57-58.

(2) For individual and corporate income taxes, what is the Service's most current estimate of the value of one percentage point of voluntary compliance for tax years 1983, 1984 and 1985?

(3) What increased administrative efforts would result in a one percent increase in voluntary compliance above authorized FY 1985 levels? (a) To what extent would the level of examination coverage have to be increased? (b) What amount of additional appropriations would be necessary? (c) How many additional staff positions would be required? (d) What would the yield to cost ratio be? (e) How should additional positions be allocated among various IRS programs (including between examination and collection functions)?

(4) Please provide data (as outlined in (3) above) indicating the impact and changes needed to achieve a \$1 billion, \$2 billion, and \$4 billion increase in additional Federal revenues. Also, provide similar information for increasing the 5 FY 1985 audit coverage (and FY 1986, if possible) to actual 1983 levels (1.56 percent), and to various percentage increases up to 6 percent (i.e., 2 percent, 3 percent, etc.).

This is essentially a request for an update of the information I received from you by your letter dated April 5, 1984.

I look forward to your timely response and assistance. If possible, we would like to have this information by December 21, 1984. If you have any questions, please feel free to contact Rusty Guritz, Assistant Counsel of the Subcommittee staff, at 225-5522.

Sincerely,

CHARLES B. RANGEL,
Chairman.

COMMISSIONER OF INTERNAL REVENUE,
Washington, DC, February 25, 1985.

Hon. J.J. PICKLE,

Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: This is in response to former Chairman Rangel's letter of December 3 in which he asked for information concerning staffing levels and allocation of resources for the Internal Revenue Service. I appreciate the continued interest in voluntary compliance and the impact that various resource levels have on federal revenues. I am enclosing detailed answers to the four questions that he asked.

In requests for resources, the Service will continue to emphasize tax enforcement and revenue collection, while at the same time increasing productivity and streamlining operations.

With kind regards,

Sincerely,

ROSCOE EGGER.

Enclosures.

Question 1. How would the Service allocate additional staffing over the authorized FY 1985 levels at each of the following levels: (a) 500 additional staff; (b) 1,500 additional staff; (c) 3,500 additional staff; and (d) 5,000 additional staff? What would the yield to cost ratio be for each level?

Answer. Revenue is a major consideration of the Service in allocating resources, but another important consideration is a balanced program—one that addresses compliance as well as revenue.

The Internal Revenue Service would allocate the first 2,500 staff years for additional revenue collection to examining tax returns including those returns which have a significant effect on non-compliance. There are some areas which are very non-compliant but are costly to examine; nonetheless, we would devote some resources to these areas to attempt to stem non-compliance.

The Service would devote the next 1,000 staff years to follow-up on unreported income and non-filing identified by matching information returns. The final 1,500 staff years would be devoted to taxes owed but unpaid.

	Staff years	Cost (millions)	Ultimate collected revenue (millions)	Yield/cost
Function:				
(a) Examination	500	\$23.6	¹ \$377	16.0
(b) Examination	1,500	70.9	¹ 546	7.7
(c) Examination	2,500	117.9	¹ 659	5.6
Information returns	1,000	26.9	¹ 438	16.3
(d) Examination	2,500	117.9	¹ 659	5.6
Information returns	1,000	26.9	¹ 438	16.3
Collection	1,500	60.3	363	6.0

¹ Includes revenue collected in subsequent years resulting from assessments proposed in the initial year.

INTERNAL REVENUE SERVICE—ULTIMATE COLLECTED REVENUE

(Dollar amount in millions)

Function	Staff years	Fiscal year					Total
		1986	1987	1988	1989	1990	
(a) Examination ¹	500	\$281,770	\$43,657	\$15,872	\$11,913	\$23,788	\$377,000
(b) Examination ¹	1,500	\$408,080	\$63,227	\$22,987	\$17,254	\$34,452	\$546,000
(c) Examination ¹	2,500	\$492,537	\$76,312	\$27,744	\$20,824	\$41,583	\$659,000
Information Returns ¹	1,000	346,896	48,180	22,338	13,140	7,446	438,000
Total	3,500	\$839,433	\$124,492	\$50,082	\$33,964	\$49,029	\$1,097,000
(d) Examination ¹	2,500	\$492,537	\$76,312	\$27,744	\$20,824	\$41,583	\$659,000
Information Returns ¹	1,000	346,896	48,180	22,338	13,180	7,446	438,000
Collection	1,500	363,000					
Total	5,000	\$1,202,433	\$124,492	\$50,082	\$33,964	\$49,029	\$1,460,000

¹ Subsequent year revenues resulting from assessments proposed in fiscal year 1986.

Question 2. For individual and corporate income taxes, what is the Service's most current estimate of the value of one percentage point of voluntary compliance for tax years 1983, 1984 and 1985?

Answer. Our latest projections of tax gaps produce the following estimates of the effects of one-percentage-point changes in corporate and individual compliance rates.

(In billions of dollars)

	Individual	Corporation	Total ¹
Tax year:			
1983	\$3.6	\$0.6	\$4.1
1984	3.7	0.8	4.5
1985	4.1	0.9	5.0
1986	4.5	1.1	5.6

¹ Totals may not add due to rounding.

Question 3. What increased administrative efforts would result in a one percent increase in voluntary compliance above authorized FY 1985 levels? (a) To what

extent would the level of examination coverage have to be increased? (b) What amount of additional appropriations would be necessary? (c) How many additional staff positions would be required? (d) What would the yield to cost ratio be? (e) How should additional positions be allocated among various IRS programs (including between examination and collection functions)?

Answer. It is difficult to quantify the value of a change in examination coverage on voluntary compliance. Voluntary compliance with Federal income tax laws reflects not only IRS enforcement efforts, but also social, economic and cultural factors.

Of critical importance is tax reform for fairness, simplicity and economic growth. Since complexity and the perceived inequity of tax laws are disincentives to voluntary compliance, tax simplification should remove many barriers that taxpayers now have in complying fully with the tax laws. Moreover, tax simplification should allow us to use resources more effectively by concentrating efforts on areas of low compliance which are not materially affected by proposed legislation, and by releasing staff currently used to administer complicated tax matters.

Question 4. Please provide data (as outlined in (3) above) indicating the impact and changes needed to achieve a \$1 billion, \$2 billion, and \$4 billion increase in additional Federal revenues. Also, provide similar information for increasing the FY 1985 audit coverage (and FY 1986, if possible) to actual 1983 levels (1.5 percent), and to various percentage increases up to 6 percent (i.e., 2 percent, 3 percent, etc.).

Answer. The estimated coverage in the FY 1985 budget request was 1.42%. However, at mid-point in the current fiscal year (FY 1985), the addition of enforcement personnel would not result in closing a significant number of additional examinations. Such an increase would enhance the examination program in FY 1986.

The 2,500 staff-year increase in Examination in FY 1986 that is shown in our response to question (1) represents the maximum staff-year increase that Examination can effectively absorb in one year. That increase would result in an examination coverage rate of 1.50%, an estimated increase of \$659 million in eventual collections (resulting from assessments proposed in FY 1986), a cost of approximately \$117.9 million (including support and follow-up costs), and a yield to cost ratio of 5.6.

A similar increase of another 2,500 staff-years in FY 1987 (a total increase of 5,000 staff-years over the 1985 staff levels) would raise examination coverage to 1.70% with eventual collections (resulting from assessments proposed in FY 1987) of approximately \$1.9 billion more than could be collected through examination efforts with FY 1985 staffing levels. The total cost of these 5,000 additional staff-years, support and follow-up would be \$221.1 million with a yield to cost of 8.8.

With an additional increase of 2,500 staff-years in FY 1988 (a total increase of 7,500 staff-years over the 1985 staff levels), examination coverage would rise to 1.90% and estimated eventual collections (resulting from assessments proposed in FY 1988) would be \$3.1 billion more in FY 1988 than the FY 1985 level of staffing could produce. The total cost of these 7,500 additional staff-years, support and follow-up would be \$328.5 million with a yield to cost of 9.5.

The maximum possible expansion that Collection could absorb in one year is 2,500 staff-years. Such an expansion would increase collected revenue by about \$600 million in the first year and about \$1 billion in each subsequent year. The total cost of these 2,500 additional staff-years, support and follow-up would be approximately \$100.6 million and would result in a yield to cost of 6.0 in the initial year and 11.3 in subsequent years.

INTERNAL REVENUE SERVICE—ULTIMATE COLLECTED REVENUE

[Dollar amounts in millions]

Function	Staff years	Fiscal year—					Total
		1986	1987	1988	1989	1990	
Examination ¹							
Fiscal year 1986	2,500	\$492.5	\$76.3	\$27.7	\$20.8	\$41.6	\$659.0
Fiscal year 1987	5,000		1,447.6	224.3	81.5	61.2	\$1,936.8
Fiscal year 1988	7,500			2,322.2	359.8	98.2	3,107.1
Total		492.5	1,523.9	2,574.2	462.1	233.6	5,702.9
Collection	2,500	608.0	982.0				

¹ Subsequent year revenues resulting from assessments proposed in fiscal years 1986, 1987, and 1988.

COMMISSIONER OF INTERNAL REVENUE,
Washington, DC.

Hon. J.J. PICKLE,

Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: Enclosed are responses to the five questions raised in your April 17 letter concerning the Service's FY 1986 budget.

The non-enforcement staffing allocations provided in answer to question one emphasize the improvements to programs that involve processing of tax returns, responding to taxpayer correspondence, and answering taxpayer inquiries through the taxpayer service programs. While these allocations reflect the Service's general priorities at the various options, more lengthy consideration could result in some adjustments.

If we can be of further assistance, please let me know.

With kind regards,

Sincerely,

ROScoe EGGER.

Enclosures.

Question 1. How would the Service allocate additional staffing over the proposed FY 1986 levels for all the non-enforcement functions, including appeals, tax litigation, and criminal investigations at each of these levels: 500, 1,000, 1,500, 2,000 and 3,000 additional staff? What would the cost be at each level? What would the yield-to-cost ratio be for total Service-wide staffing based on the proposed FY 1986 budget, taking into account each level of additional staffing for non-enforcement functions?

Answer. The Service's allocation of the additional non-enforcement staffing options is summarized on the attached table. More extensive consideration and review might suggest the need for some adjustments in these allocations, but essentially they reflect the Service's priorities.

The principal tax processing and taxpayer service programs received primary emphasis. Enhanced quality of service to the public, improved responsiveness, and the ability to better deal with increased workload would result from these staffing allocations.

The yield-to-cost ratio for total Service-wide staffing in the proposed FY 1986 budget is approximately 9.7 dollars in direct enforcement revenue collections for each dollar spent. While the additional allocation of up to 3,000 average positions in non-enforcement programs increases the quality and responsiveness of Service operations and thus contributes to improved voluntary compliance, we are unable to measure these specific effects in revenue terms.

Briefly, the anticipated allocation of each of the options is as follows:

500 average positions (\$20 million)

These positions would be used principally in our service centers to improve computer operations and assure staffing levels sufficient to process expected growth in the volume of tax returns filed. Also, increases to Taxpayer Service and other programs would result in our assisting 1.7 million additional taxpayers and would strengthen our problem resolution program.

1,000 average positions (\$42 million)

In addition to the above, these positions would be used in our service centers to 1) further strengthen computer operations and 2) improve the timeliness and quality of taxpayer correspondence. We would also apply resources to Appeals and Tax Litigation to close an additional 9,500 tax shelter cases.

1,500 average positions (\$66 million)

In addition to the above, these positions would be used to further improve the quality of taxpayer correspondence, strengthen our problem resolution program and assist an additional 1.3 million taxpayers. We would also issue an additional 10,000 pension plan determinations, close an additional 2,500 tax shelter cases and enhance our review of internal and managerial controls over the Service's new automated computer systems.

2,000 average positions (\$81 million)

In addition to the above, these positions would further improve the timeliness, clarity and accuracy of taxpayer correspondence. Improvement to the Service's correspondence practices and procedures would provide better service to taxpayers and reduce taxpayer burden in communicating with the Service on errors, adjustments and account discrepancies.

3,000 average positions (\$116 million)

In addition to the above, these positions would be used to assist an additional 2.6 million taxpayers, issue an additional 20,000 pension plan determinations, close an additional 2,660 more tax shelter cases, initiate an additional 570 fraudulent tax haven/foreign trust investigations and provide a reasonable balance in all Service programs to carry out related IRS responsibilities.

INTERNAL REVENUE SERVICE—FISCAL YEAR 1986 BUDGET AND ALLOCATION OF ADDITIONAL OPTIONS

Program	Fiscal year 1986 budget	Allocation of additional average positions				
		+ 500	+ 1,000	+ 1,500	+ 2,000	+ 3,000
Returns processing, taxpayer correspondence	21,336	350	725	875	1,375	1,495
Taxpayer service	4,214	125	125	225	225	425
Computer service	1,510					90
Tax fraud investigations	4,413					265
Appeals and tax litigation	3,537		125	205	205	240
Enforcement litigation and rulings	1,433					80
Employee plans and exempt organizations	2,401			50	50	150
Other programs	47,645	25	25	145	145	255
Total average positions	86,489	500	1,000	1,500	2,000	3,000
Budget dollars (millions of dollars)	\$3,511	\$20	\$42	\$60	\$81	\$116

Question 2. How would the Service allocate additional funding over the proposed FY 1986 levels for all non-enforcement functions, including appeals, tax litigation, and criminal investigations at each of these levels: \$25 million, \$50 million, \$75 million, and \$100 million? What would the yield-to-cost ratio be Service-wide based on the proposed FY 1986 budget, taking into account each additional funding level for non-enforcement functions?

Answer. The Service's allocation of the additional non-enforcement funding options is summarized below. More extensive consideration and review might suggest the need for some adjustments in these allocations, but essentially they reflect the Service's priorities.

Regarding the impact of these additional funding levels on the Servicewide yield-to-cost ratio, as with question (1), we are unable to measure the potential revenue impact of the improved tax administration resulting from these allocations.

Briefly, the anticipated allocation of each of the options are as follows:

\$25 million

These funds would be used to avoid general reductions in most Service programs by financing deficits in mandatory space rental, printing of tax packages, and toll-free telephone requirements.

\$50 million

In addition to the above, these funds would be used to strengthen technical and computer training and to finance ADP systems improvements in our service centers for remittance processing, data input and upgraded computer capacity.

\$75 million

In addition to the above, these funds would be used for additional ADP systems improvements in our service centers for automated scheduling, and controlling assessments and notices.

Systems improvements would also be funded for taxpayer service electronic refund telephone equipment, tax fraud investigations automation and employee plans and exempt organizations determination work.

\$100 million

In addition to the above, these funds would be used for additional ADP and systems modernization initiatives in tax processing, appeals and tax litigation, and employee plans and exempt organizations. We would further finance taxpayer education for self-employed and elderly taxpayers, continuing legal education and com-

puter-based training. Funds would also be used for contractual services to provide compliance research and a required risk analysis of our tax processing centers and for an unbudgeted requirement to print federal tax deposit coupon books.

Question 3. Please provide a breakdown of the staffing for major programs under each of the four appropriations accounts which shows: (a) IRS FY 1986 Budget Submission to the Treasury Department; (b) IRS FY 1986 Budget Submission to the Office of Management and Budget; and (c) the IRS FY 1986 Budget Submission to Congress.

Also, how much revenue would be brought in under each of those three budget proposals?

Answer. See attached chart.

INTERNAL REVENUE SERVICE SUMMARY STAFFING [FTE]

	Fiscal year 1986 Treasury submission	Fiscal year 1986 OMB submission	Fiscal year 1986 congressional submission
Salaries and expenses:			
Executive direction	131	131	127
Management services	2,184	1,974	1,944
Total salaries and expenses	2,315	2,105	2,071
Processing tax returns:			
Returns processing and revenue accounting	22,907	22,060	21,336
Compute services	1,740	1,680	1,510
Total processing tax returns	24,647	23,740	22,846
Examination and appeals:			
Examination	33,058	30,659	29,518
Appeals and tax litigation	3,890	3,762	3,537
Employee plans and exempt organizations	2,537	2,517	2,401
Total examination and appeals	39,485	36,938	35,456
Investigation, collection and taxpayer service:			
Tax fraud investigation	4,851	4,555	4,413
Collection	17,915	16,551	16,056
Taxpayer service	4,417	4,313	4,214
Enforcement litigation and rulings	1,650	1,650	1,433
Total investigation, collection and taxpayer service	28,833	27,069	26,116
Total, IRS	95,280	89,852	86,489
Direct enforcement revenue (billions)	\$36.4	\$34.5	\$34.1

Question 4. What would the cost and program effects be for expanding taxpayer service at each of the following staffing levels above that proposed in the Administration's FY 1986 budget request: 200, 400, 600, 800, and 1,000 additional staffing?

Answer. The mission of Taxpayer Service—to provide taxpayers with the assistance they need to comply with the tax laws—is most effectively accomplished with a program that balances quality assistance with cost-effective assistance. The funding levels shown here apply this principle by planning for a mixture of employee training, quality review and toll-free telephone assistance for the public, augmented—at the higher levels—by an enhanced Outreach program and tax seminars for self-employed individuals.

Program impact and accomplishments

Level A:	Expansion level
Quality review: average positions	6
Training: average positions	18
Telephone assistance: average positions	176
Total average positions	200

Additional taxpayers assisted.....	2,604,000
Level B:	
Quality review: average positions.....	12
Training: average positions.....	36
Telephone assistance: average positions	352
Total average positions.....	400
Additional taxpayers assisted.....	5,209,000
Level C:	
Quality review: thirteen average positions.....	13
Training: eighty-seven average positions.....	87
Telephone assistance: three hundred eighty-seven average positions...	387
Outreach program: eighty-eight average positions	88
Tax seminars for self-employed: twenty-five average positions	25
Total average positions.....	600
Additional taxpayers assisted.....	6,443,000
Level D:	
Quality review: fifteen average positions.....	15
Training: eighty-seven average positions.....	87
Telephone assistance: four hundred thirty-one average positions.....	431
Outreach program: two hundred forty-two average positions	242
Tax seminars for self-employed: twenty-five average positions	25
Total average positions.....	800
Additional taxpayers assisted.....	8,172,000
Level E:	
Quality review: twenty-two average positions.....	22
Training: eighty-seven average positions.....	87
Telephone assistance: six hundred twenty-four average positions.....	624
Outreach program: two hundred forty-two average positions	242
Tax seminars for self-employed: twenty-five average positions	25
Total average positions.....	1,000
Additional taxpayers assisted.....	11,204,000

Question 5. Please update, to any extent necessary, your letter of February 25, 1985 regarding IRS staffing levels and allocation of resources to take into account fiscal year 1986 projections.

Answer. Information in my February 25, 1985 letter concerning staffing levels and allocations of resources takes into account fiscal year 1986 projections. This information remains current.

INTERNAL REVENUE SERVICE

SCRS SYSTEMS IMPROVEMENT PROGRAM

MANAGEMENT SUMMARY

During early 1985, the Internal Revenue Service recognized that a capacity problem would be experienced in each of its ten service centers on the UNIVAC Service Center Replacement Systems (SCRS). The capacity problem was projected to occur with implementation of the third of four phases of SCRS in October 1984 in all ten service centers. The primary problem was that the weekend workload would exceed the two days available for weekend processing.

As a result, immediate steps were taken to develop a plan of action to alleviate the problem. Action was initiated on several interim remedies for 1985. These are:

1. Software optimization, which involves improving the use of the Univac database management system and the COBOL coding on the SCRS application programs to achieve more efficiency. The software optimization effort is part of a long term plan to improve many IRS applications. A task force was initiated to evaluate and optimize the twelve programs that used the greatest amount of computer resources (i.e., CPU time). *This effort has already resulted in a CPU time reduction of 47% and is projected to exceed a 50% reduction by November 1984.* The next step of the

optimization effort is to evaluate the remaining applications that use large amounts of CPU time, using the knowledge gained in the initial effort. These steps will be continued on a scheduled basis for all applications that consume more than a predetermined amount of CPU time (e.g., one hour). Additionally, lessons learned about the database management system, COBOL, and systems design will be formally disseminated to programmer/analysts. IRS is also developing a procedure that will require development personnel to use an automated tool to perform an efficiency review and to verify thorough unit (program) testing, prior to systems tests. These efforts will result in a greater emphasis on efficiency, maintainability and portability throughout the development process.

2. Exercise all available hardware options in the current SCRS contract—essentially, this means acquiring additional standalone UVIVAC 1100/82 systems to augment the 110/84's at the four largest service centers and the National Computer Center. These additional systems must be in place by early 1985 to provide adequate capacity for the 1985 peak processing period.

3. Upgrade the Distributed Input System (DIS) and offload some SCRS daily batch work. A field upgrade to the DIS master node is needed by January 1985. Although this is a necessary partial remedy to a future daily workload problem, it will not help alleviate the most critical problem—weekend batch processing.

Even with these remedies in place, the Service will again run out of SCRS capacity by the beginning of the 1986 peak processing period at those centers which do not receive 1100/82's in 1985, and at the other four centers by 1987. This is due to (1) the continued growth in the number of returns (projected at 7 million for 1985 and 6 million for 1986), (2) additional high yield applications which must be added (such as automated Underreporter), and (3) possible tax reform legislation. The IRS has initiated a plan, predicated on the growth of returns processing through 1990, to redistribute the service center workload in January 1986. Although this "workload levelling" will distribute the work more evenly among the centers, it will not resolve the SCRS capacity problem. In fact, it will aggravate the situation at those centers which might not receive 1100/82's in 1985 and it will not permit the over saturated centers to accomplish their workload on a timely basis. In addition to continued software optimization, the only solution is to replace the current SCRS system before 1987 with one that has significantly more CPU capacity. In order to acquire the new system in the required timeframe, a sole-source procurement strategy should be followed to acquire an expandable Sperry 1100/90 series system before 1987. The new replacement system must be acquired and installed at the program development site by August 1985, then passed in on a site by site basis from February 1986 through December 1986. This will enable the IRS to handle the 1986 and 1987 workload, and provide for future growth beyond 1990.

To obtain necessary support for the required replacement system procurement strategy, a presentation was provided to the Deputy Assistant Secretary (ESIT), Department of Treasury, and the Deputy Assistant Administrator, Office of Information Resources Management, GSA. IRS and Treasury representatives also met with the Deputy Commissioner for Data Processing at SSA to benefit from what SSA has learned in its ADP systems replacement effort.

Further, a subsequent meeting with the Director of the GSA, Federal Conversion Support Center, resulted in an understanding that IRS would document efforts already underway, as well as those that are planned, to improve its SCRS system. It was also recognized at the meeting that IRS was taking action on several initiatives which go beyond improving the effectiveness of just the software, specifically initiatives that maximize the efficiency, effectiveness and economy of the overall system, operations, and the ADP organization. Accordingly, the attached document describes all aspects of our SCRS System Improvement Program. It describes actions currently underway as well as those which are planned for the future. These actions are directed at improving the efficiency of SCRS, but will also benefit other computer systems that are being utilized in the Service.

1. INTRODUCTION

1.1 CONTENT AND PURPOSE OF THE SYSTEMS IMPROVEMENT PROGRAM (SIP) DOCUMENT

This SIP document describes the administration of existing software, hardware, and operational and procedural improvement/engineering technology efforts, and serves as a master source of information on the ongoing conversion, enhancement, and refinement activities relating to the Internal Revenue Service's SCRS replacement effort.

The content of the document is as follows:

Introduction—provides an overview of the Service's efforts over the past decade toward a more efficient and effective tax administration system. It describes the events leading to the current operating environment.

Description of environment—describes the current and future operating environments, work methodologies and users.

Description of systems improvement program—discusses ongoing improvement efforts. Describes standards, procedures, quality assurance, training and tools in place as well as various software/hardware, operational and procedural improvement efforts.

Summary—emphasizes efforts to date and planning considerations for future improvement efforts.

1.2 BACKGROUND AND HISTORICAL INFORMATION

In 1975, the Office of Management and Budget approved the Tax Administration System [TAS] which was to be a decentralized system whereby accounts would be maintained at the ten service centers. Three years later, however, TAS was denied funding by Congress due to privacy and security concerns and high costs.

Since improvements to the system at that time were critical, a second project, the Equipment Replacement and Enhancement Plan [EREP], ensued which would retain the current processing environment while replacing and enhancing the computer equipment. EREP would provide for the future Service Center Replacement System [SCRS], Master File Replacement System [MFRS], and the Microfilm Replacement System [MRS]. Later, though, with an end toward accelerating SCRS, the IRS was mandated to limit EREP to just the replacement of aging and saturated equipment. This new effort was called the Equipment Replacement Program [ERP].

In conjunction with ERP the decision was made to convert current service center applications from assembler language to COBOL. Following issuance of a SCRS feasibility study and the Request for Proposals, Sperry UNIVAC Inc. was awarded in 1981 a contract for eleven computer systems with upgrades.

An intensive training effort on structured methodologies and conversion of application programs was begun.

A live test conducted in March 1984 projected that 1985 weekend processing would require 186 CPU hours compared with only 100 CPU processing weekend hours available. This figure was revised based on measurements of Memphis Service Center's production to 240 CPU hours required. When the fourth and final phase of SCRS is implemented in January 1985, the capacity problem will worsen. It is projected that the four high volume centers will require three to four days to perform weekend processing, instead of the available two days.

Contributing factors include the fact that SCRS was originally planned as a strict rollover of existing processing operations, so it was sized to allow for only 8 percent annual growth (2-3 percent for growth in returns, and 5-6 percent for unanticipated legislated tax law changes). No allowance was made for self initiated enhancements or additions common to a system of this size and complexity. In addition, Sperry sized the system very tightly, leaving no margin for error or capacity for enhancements. Enhancements were soon implemented, however, in consideration of the current Administration's emphasis on cost beneficial automation.

To illustrate the extent of the capacity problem, the SCRS contract initially called for eleven 1100/82 (two CPU's) computer systems, and was only scheduled to be upgraded to 1100/83's (three CPU's) during the eight-year life of the system. Due to the capacity problems, however, the addition of the third CPU was accelerated to early 1984, and a fourth CPU (which was never envisioned) will be installed. (The system can only be upgraded to four CPU's, which is an 1100/84).

This hardware upgrade has been paralleled by a software optimization effort addressing the capacity problem through improvement of the UNIVAC database management system and COBOL code in the largest SCRS applications programs. This optimization effort has resulted in a CPU time reduction of 47 percent and is projected to exceed a 50 percent reduction by November 1984. These efforts are being incorporated in an ongoing optimization program to improve many IRS applications.

While hardware upgrades and software optimization efforts have served to provide interim remedies, work has begun on a longer term solution, the replacement of the SCRS equipment. This effort will ensure the resources necessary to accomplish the Service's tax administration mission into the 1990's.

UNITED STATES GENERAL ACCOUNTING OFFICE,
Washington, DC, April 26, 1985.

Hon. J.J. PICKLE,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives.

DEAR MR. CHAIRMAN: The enclosed document summarizes information on IRS' taxpayer assistance activities on which we briefed your staff on April 24, 1985. The document contains information on the (1) difficulty taxpayers have understanding IRS forms and publications, (2) changes in the way IRS is distributing its staff resources, and (3) results of a GAO survey of IRS' toll free telephone assistance system during part of the 1985 filing season.

Since we only had several weeks to complete the work for the briefing, we were unable to do as much work as we have done in prior reviews of taxpayer assistance matters. Therefore, the data should be viewed individually and not as a trend or absolute measures of the level of service provided.

We trust this information will be useful in your evaluations of the adequacy of the quality and quantity of IRS' taxpayer assistance activities. If you have any questions, please let us know.

Sincerely yours,

WILLIAM J. ANDERSON,
Director.

Enclosure.

TAXPAYER DIFFICULTY IN UNDERSTANDING IRS FORMS AND PUBLICATIONS

Our prior reviews and a recent review by IRS indicate that taxpayers continue to have difficulty in understanding IRS forms and publications.

In our 1978 report *Further Simplification of Income Tax Forms and Instructions is Needed and Possible* (GGD-78-74, July 5, 1978), we concluded that Form 1040 packages were written at a reading level beyond the comprehension of many taxpayers. As a result, IRS initiated actions to make forms and instructions easier to read and understand. In fiscal year 1982, IRS tested a simplified version of the Form 1040A and accompanying instructions. In fiscal year 1983, IRS introduced Form 1040 EZ which has half as many lines as the form 1040A. IRS reported that between January 1 and August 11, 1984 approximately 19 million 1040As and 15 million 1040EZs were filed.

Our report on the *Need to Better Assess Consequences Before Reducing Taxpayer Assistance* (GGD-84-13, April 5, 1984) showed that taxpayers were still having difficulty understanding IRS' written materials. The questionnaire we sent to taxpayers in 1982 contained a question relating to the clarity of IRS tax forms, instructions, and publications. And, as shown below, the responses we received indicated that, even after IRS' simplification efforts, a significant percentage of taxpayers continued to have difficulty in understanding IRS' written documents.

Taxpayer categories	Tax forms and instructions	Publications
All taxpayers.....	41	22
Telephone assistance users.....	33	29
Walk-in assistance users.....	43	36
Correspondence assistance users.....	39	35

An IRS sponsored survey conducted during the period May to July 1984 also showed a continuing problem for taxpayers. Most people surveyed (55 percent) rated IRS forms and rules for their particular tax situation as complicated and difficult to understand. Thus, IRS action taken so far continues to leave about half of the individual taxpayer population having difficulty understanding IRS forms and publications.

Because the Internal Revenue Code has evolved into an extremely complicated array of exemptions, exclusions, deductions, and credits, taxpayers often need assistance in meeting their tax obligations. Among other things, taxpayers frequently need help in the form of return preparation and/or answers to questions relating to tax law requirements. In fiscal year 1984, 42 million, or 44 percent, of the 96 million individual tax returns filed were prepared by someone other than the taxpayer—IRS, commercial and volunteer assisters. IRS also answered tax law questions over

the telephone, at walk-in offices, and through correspondence. According to IRS statistics, during fiscal year 1984, taxpayers asked IRS about 23.4 million tax law questions—20.7 million by telephone, 2.6 million at walk-in offices, and 67,000 via correspondence.

IRS RESOURCES DEVOTED TO TAXPAYER ASSISTANCE FOR FISCAL YEAR 1985

Our review of IRS 1985 budget estimates and discussions with IRS officials indicate that there has been a reduction in the number of personnel available to assist taxpayers in recent years. Since actual figures are unavailable, we used IRS' budget estimates to estimate the number of available assisters. Our estimate shows that available assisters will decline from 8,243 in 1984 to 7,416 in 1986.

In fiscal year 1985, IRS redistributed its staff resources devoted to taxpayer assistance. As shown in appendix I, IRS planned to increase the number of permanent taxpayer positions for fiscal year 1985 by 158 and to detail in an additional 124 staff years from other IRS units to taxpayer service on a temporary basis. At the same time, IRS planned to decrease the number of staff years for part time/temporary employees by an estimated 351. IRS' budget reduction of staff years for part time/temporary personnel results in the loss of many more assistance personnel than the actual number of staff years reduced. For permanent positions, one staff year provides for only one person working the entire year. For temporary positions, one staff year usually provides for several persons working part of the year to address the peak demand during the filing season.

IRS does not have information on the impact of this redistribution on availability of assisters during the filing season. However, IRS officials acknowledge that there has been a decline in the number of assisters available. To obtain an indication of the impact, we prepared an estimate based on the assumption that all temporary assisters work during the filing season. As shown in appendix I, this estimate indicates that the number of assisters available declined by about 523 between the 1984 and 1985 filing seasons. However, this estimate does not show the precise number of assisters available each year because, among other things, not all temporary assisters work during the filing season. Rather, this estimate is intended to show that the effect on the number of assisters available is greater than the staff year reduction shown in the budgets.

According to IRS headquarters officials, this redistribution of staff resources was done because more full time employees were needed year round to handle an increase in workload during the May-September post filing period. These officials attributed this increase workload to taxpayers demand for assistance regarding refunds and service center notices. An IRS official at the district level, however, told us that this redistribution of resources adversely affected the timeliness and accuracy of the telephone assistance provided to taxpayers during the 1985 filing season.

IRS' PLANNED TAXPAYER ASSISTANCE RESOURCES FOR FISCAL YEAR 1986

Our review of budget estimates and discussions with IRS officials indicate that the reduction in the number of personnel available to assist taxpayers will continue in fiscal year 1986.

In fiscal year 1986, IRS plans a further redistribution of its staff resources devoted to taxpayer assistance. As illustrated in appendix II, IRS plans to decrease the number of permanent taxpayer service positions for fiscal year 1986 by 82 and the number of detailed-in staff years by 84. At the same time, IRS plans to increase the number of staff years for part time/temporary employees by 10. Again, assuming that each detailed-in and part time/temporary taxpayer service staff year budgeted would provide about three assisters during the filing season, the maximum number of assisters available will decrease by 304 for the fiscal year 1986 filing season.

RESULTS OF 1985 SURVEY OF IRS TELEPHONE ASSISTANCE

To assess the effect of IRS' reallocation of resources on telephone assistance, we conducted a telephone survey during the 15-day period March 27, 1985 to April 10, 1985 similar to the ones we conducted during the 1978 and 1982 filing seasons. The methodology we used on the three surveys is shown in appendixes III, IV and IX. Although the surveys were similar, there are differences in methodology, e.g., periods covered. Therefore, caution must be taken in making any year-to-year comparisons. However, IRS national office officials said that the trend for services provided is downward.

As shown in appendixes IV, VII, and X, we estimated that a taxpayer could expect to reach an IRS assister on the first call 31 percent of the time in 1985, 62

percent of the time in 1982, and 78 percent of the time in 1978. Furthermore, a taxpayer willing to make multiple calls to IRS had a 70 percent chance in 1985 of reaching an assister within a total of five call attempts. Taxpayers in 1982 and 1978 could expect to reach an IRS assister 85 percent and 86 percent of the time, respectively, within five call attempts. The results of the three tests should not be viewed as precise measures of the level of IRS provided assistance.

Calls may not be completed for a variety of reasons. For example, IRS can disconnect a taxpayer's call before an assister answers; a taxpayer can personally terminate a call after waiting on hold for a period of time (for our test, we waited on hold for 15 minutes); or a taxpayer may encounter a busy signal, a recording advising the taxpayer to call back at another time, or a continuous ringing without an answer.

Besides problems with calls not completed, taxpayers also could experience problems with inaccurate responses. As shown in appendixes V, VIII, and XI, in 1978 12 percent and in 1982 11 percent of the total calls made to IRS resulted in an inaccurate response to a question. In 1985, 14 percent of the telephone assister responses were inaccurate. IRS officials reviewed our questions and answers and agreed that the answers we sought were correct.

Appendixes V, VIII, and XI show the inaccuracy rates with data on calls not completed and terminated calls for each test period. The data show that for each 100 telephone calls made to IRS in 1985, 52 resulted in contact with an IRS assister who correctly answered a question. The remaining 48 calls either did not get answered, were cut off, or resulted in assisters providing erroneous answers. In 1982, 72 calls out of 100 resulted in contact with an IRS assister who correctly answered a question. In 1978, 80 calls out of 100 resulted in a correct answer.

IRS national office officials responsible for IRS taxpayer assistance program concurred with our 1985 test results which indicated that the availability of assistance declined while the accuracy of assistance remained about the same. They attributed the decline in availability to public reaction to the widespread publicity given to alleged problems with refunds and shredding of returns which started in late January 1985.

APPENDIX I

TAXPAYER SERVICE BUDGET ESTIMATES FISCAL YEAR 1984 TO 1985 COMPARISON

Average positions	Staff years		Filing season impact		
	1984	1985	Increase (decrease)	Persons per staff year	Increase (decrease)
Full time permanent:					
Taxpayer service specialist	534	758			
Taxpayer service representative	1,036	1,188			
Other permanent	967	749			
Subtotal	2,537	2,695	158	1	158
Part time/temporary	1,846	1,495	(351)	3	(1,053)
Detailed-in:					
Revenue officer	4	14			
Tax auditor	15	104			
Revenue agent	37	62			
Subtotal	56	180	124	3	372
Total	4,439	4,370	(69)		(523)

TAXPAYER SERVICE BUDGET ESTIMATES FISCAL YEAR 1985 TO 1986 COMPARISON

Average positions	Staff years		Filing season impact		
	1985	1986	Increase (decrease)	Persons per staff year	Increase (decrease)
Full time permanent:					
Taxpayer service specialist	758	733			
Taxpayer service representative	1,188	1,155			
Other permanent	749	725			

TAXPAYER SERVICE BUDGET ESTIMATES FISCAL YEAR 1985 TO 1986 COMPARISON—Continued

Average positions	Staff years			Filing season impact	
	1985	1986	Increase (decrease)	Persons per staff year	Increase (decrease)
Subtotal.....	2,695	2,613	(82)	1	(82)
Part time/temporary.....	1,495	1,505	10	3	30
Detailed in:					
Revenue officer.....	14	14			
Tax auditor.....	104	30			
Revenue agent.....	62	52			
Subtotal.....	180	96	(84)	3	(252)
Total.....	4,370	4,214	(156)		(304)

APPENDIX III

1978 GAO telephone survey—methodology

Number of telephone calls.....	873
Time period:	
Dates.....	3/6-3/8
Calendar days.....	3
Business days.....	3
Number of existing IRS sites contacted.....	20 of 70
Number of tax law questions used.....	14

APPENDIX IV

1978 GAO TELEPHONE SURVEY—COMPLETED CALLS

	Number	Percent
Calls placed before reaching assister:		
One.....	682	78
Two.....	96	11
Three.....	34	4
Four.....	17	2
Five.....	10	1
Total completed calls.....	839	96
Calls not completed.....	34	4
Total calls attempted.....	873	100

APPENDIX V

1978 GAO TELEPHONE SURVEY—SUCCESSFUL CALLS

	Number	Percent
Total calls attempted.....	873	100
Calls not completed.....	34	4
Terminated calls ¹	36	4
Completed calls resulting in accurate answers.....	108	12
Total calls made which were completed and resulted in an accurate response.....	695	80

¹ Terminated calls include those lost during discussion with an assister and those lost during referral to back up assisters.

APPENDIX VI

1982 GAO telephone survey—methodology

Number of telephone calls.....	1,092
Time period:	
Dates	1/25-3/31
Calendar days.....	66
Business days.....	48
Number of existing IRS sites contacted.....	¹ 49 of 52
Number of tax law questions used.....	² 20

¹ We excluded Anchorage, AK; Honolulu, HI; and San Juan, PR.

² Includes 10 questions from our 1978 test and 10 newly developed questions.

APPENDIX VII

1982 GAO TELEPHONE SURVEY—COMPLETED CALLS

	Number	Percent
Calls placed before reaching assister:		
One	676	62
Two	132	12
Three	67	6
Four	33	3
Five	25	2
Total completed calls.....	933	85
Calls not completed.....	159	15
Total calls attempted.....	1092	100

APPENDIX VIII

1982 GAO TELEPHONE SURVEY—SUCCESSFUL CALLS

	Number	Percent
Total calls attempted.....	1092	100
Calls not completed.....	159	15
Terminated calls ¹	17	2
Completed calls resulting in inaccurate answers.....	125	11
Total calls made which were completed and resulted in an accurate response.....	791	72

¹ Terminated calls include those lost during discussion with an assister and those lost during referral to back up assisters.

APPENDIX IX

1985 GAO telephone survey—methodology

Number of telephone calls.....	577
Time period:	
Dates	3/27-4/10
Calendar days.....	15
Business days.....	11
Number of existing IRS sites contacted.....	¹ 33 of 36
Number of tax law questions used.....	² 17

¹ We excluded Anchorage, Alaska; Honolulu, Hawaii; and San Juan, Puerto Rico.

² Includes 17 of the 20 questions from our 1982 test—3 of the questions were no longer applicable.

APPENDIX X

1985 GAO TELEPHONE SURVEY—COMPLETED CALLS

	Number	Percent
Calls placed before reaching assister:		
One.....	182	31
Two.....	102	18
Three.....	54	9
Four.....	40	7
Five.....	27	5
Total completed calls.....	405	70
Calls not completed.....	172	30
Total calls attempted.....	577	100

APPENDIX XI

1985 GAO TELEPHONE SURVEY—SUCCESSFUL CALLS

	Number	Percent
Total calls attempted.....	577	100
Calls not completed.....	172	30
Terminated calls ¹	22	4
Completed calls resulting in inaccurate answers.....	80	14
Total calls made which were completed and resulted in an accurate response.....	303	52

¹ Terminated calls include those lost during discussion with an assister and those lost during referral to back up assisters.

AMERICAN BAR ASSOCIATION,
Washington, DC, May 13, 1985.

Hon. JAKE J. PICKLE,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of
Representatives, Washington, DC.

DEAR CHAIRMAN PICKLE: The American Bar Association and its Tax Section have been seriously concerned for more than a decade as to budget and personnel limitations imposed upon the Internal Revenue Service. It was, and is, the view of the Association, and the Tax Section, that serious negative consequences result to our self-assessment tax system from such limitations.

With respect to returns processing, serious difficulties have been encountered in the Philadelphia and Austin Service Centers. It is the view of many tax practitioners that similar problems may exist in other locations. With respect to taxpayer services, our experience has been that sufficient personnel do not exist to meet the legitimate information needs of taxpayers. With respect to examination of returns, we are alarmed that the overall audit coverage is projected to fall to 1.2 percent of returns filed. Moreover, with the concentration of examination resources on returns involving tax shelters, audit coverage is even lower for individuals returns that do not involve tax shelters. The perception is increasing that the tax laws are being administered in a manner that is unfair to taxpayers who file correct returns and who pay the tax that they owe.

The Tax Section does not have access to sufficient information to say what is the most effective number of people to be employed by the Internal Revenue Service, or the exact amount of the budget that should be appropriated for the optimal operation of the Internal Revenue Service. Nevertheless, the views of responsible tax practitioners from geographically-dispersed areas of the United States are unanimous that the lack of resources available to the Service seriously impairs its ability to accomplish its important mission.

We have reviewed the Commissioner's testimony of April 29 with respect to the FY 1986 budget for the Service and are alarmed that it contemplates a decrease of 1,250 positions and \$30.4 million from the FY 1985 level. Despite the Commissioner's public statements that the requested level will provide sufficient resources, we urge, at a minimum, that there be no reductions and that these 1,250 positions be restored to the FY 1986 budget. We understand that the estimated cost of this action would be approximately \$50 million. A more desirable action would be an increase in average positions over the FY 1985 levels of another 1,750 positions, with the result that the level requested by the Commissioner would be increased by a total of 3,000 positions, at an approximate cost of \$120 million.

We recommend that any additional positions be allocated in order of priority first to returns processing, second to taxpayer services, and third to examination and collection.

We are convinced that the program that we recommend would be cost effective, both in terms of revenues produced and in terms of enhanced taxpayer confidence in the competence of the Internal Revenue Service.

Please let me know if we may assist further with this important project.

Very truly yours,

JAMES B. LEWIS,
Chairman, Section of Taxation.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS,
Washington, DC, May 20, 1985.

Hon. JAKE J. PICKLE,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Washington, DC.

DEAR CHAIRMAN PICKLE: The American Institute of Certified Public Accountants urges your Subcommittee to work for increased budget allocations for the Internal Revenue Service in the areas of return processing, examinations, and taxpayer services. We are deeply concerned that budgeted levels of staffing and resources may further weaken the Service and erode the public confidence which is essential to our self-assessment system of taxation.

In the area of returns processing, we have all been concerned with the widely publicized problems which have accompanied this individual income tax return filing season. Although the Service has done its best under the circumstances, the task is large and difficult and requires a substantial allocation of resources. The prompt and accurate processing of tax returns is essential to taxpayer trust in our system.

Clients of CPAs have a high level of compliance with the tax laws, and we believe that taxpayers who pay their fair share should not be required to shoulder the burden of those who do not. Revenues can be increased without having to raise tax rates simply by enhancing the audit capability of the Service. A well-known audit coverage rate of only 1.2 percent for individual income tax returns, with a concentration on returns which have substantial sheltered income, cannot seriously deter those who would play the "audit lottery." Past studies have shown that increased funding of the IRS examination function more than pays for itself through adjustments in returns which are examined. The additional benefit in terms of unaudited compliance improvement and respect for the system cannot be measured.

We have found that it takes longer and longer to receive a response to a written inquiry regarding a taxpayer problem. The increasing length of time for response is only one measure of the problem and frustration of taxpayers in this area. With an increasingly complex tax law, when taxpayers have a problem, they must have a responsive tax administration. Otherwise, they will lose confidence in the system, and the American tradition of working within the system could be adversely affected.

The AICPA Tax Division would be pleased to work with you to help improve the efficiency and respect for our tax system. We believe that increased budget support is essential and would be pleased to provide specific recommendations for improvements in working with your staff.

Sincerely yours,

ALBERT B. ELLENTUCK,
Chairman, AICPA Tax Division.

STATEMENT OF MARY HALE CHASE, WASHINGTON, DC

My name is Mary Hale Chase (Mrs. G. Howland Chase). I reside at 1521 29th Street, Northwest, Washington, D.C. 20007. I may be reached during the day at the American Needlework Center, Inc., 2803 M Street, Northwest, Washington, D.C. 20007 (202-337-1534). I make this statement as a citizen and taxpayer.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

As the Chairman observed in announcing this hearing, "each and every taxpayer needs to have confidence that IRS will collect taxes due the Federal Government in an appropriate, equitable and timely manner." In my experience, as a widow of eighty years of age who always has tried to be responsive to IRS requirements and requests, this confidence has been eroded by the unexplained failure of the Philadelphia center of IRS to acknowledge and correct mistakes which are made in entering data in its computers. The Philadelphia computers are programmed to print out form letters which, if not threatening in a literal sense, are always unsettling. Communications from the taxpayer elicit no response from Philadelphia. One wonders if there is any living person there. Allegedly because of staff assignments, tax questions can remain unresolved for years, resulting in substantial legal and accounting costs for those who can afford them and real risk of unfairness for those who cannot.

No private concern would be allowed to operate in this manner.

I recommend that IRS stop blaming its new computers for the inadequacies of its Philadelphia center; that IRS make available to taxpayers within Philadelphia's jurisdiction knowledgeable staff with the authority to correct IRS mistakes; and that IRS have a budget adequate to enable it to train and maintain staff to resolve issues between IRS and the taxpayer within a reasonable time.

THE PHILADELPHIA CENTER OF IRS GIVES THE IMPRESSION THAT IT LACKS THE ABILITY TO ADMINISTER THE TAX LAWS FAIRLY AND EFFICIENTLY

My late husband, George Howland Chase, died in October 24, 1981. As executrix of his will, I sent IRS a federal estate tax return on July 14, 1982, enclosing a check for the tax shown as due, the death certificate and a request for an expedited audit in accordance with Section 2204 of the Internal Revenue Code.

IRS receipted for the return and enclosures on July 16, 1982. My first communication from IRS was dated September 6, 1982. It misidentified the date of Mr. Chase's death as "January 1, 1981" and advised me that "a combined penalty has been added because your return was filed late and the tax was not paid when due." The computer, because of the error in programming the date of Mr. Chase's death, presumed in calculating interest and penalty that the return was due three weeks before Mr. Chase actually died.

On September 14, 1982, we advised IRS in writing of its error, citing the correct date shown on the return and Mr. Chase's death certificate. We asked IRS to telephone us collect once it had corrected its error. Receiving no response, in writing or by telephone, we telephoned IRS only to be told that no telephone inquiries would be accepted in order to allow time for IRS to make a written response. There was no written response. After again writing IRS on December 6, 1982, asking for acknowledgement of the error, I received a letter from IRS dated December 8, 1982, asking me for a duplicate of the return and schedules on the ground that "the one that was filed is not immediately available." We complied on December 14, 1982. I still don't know if IRS ever found the original. I do know that IRS never corrected the error, for even now I receive notices from IRS with the wrong date of death. I always protest, but there is no response.

Because Mr. Chase joined me in making a gift of our farm in Maryland to the tenant farmer and his family in 1979, I had to report half of the value of the gift on his estate tax return. Since the farm was subject to a conservation easement which Mr. Chase and I had deeded to the Maryland Environmental Trust in 1978, there arose the question of the value of the farm before and after the easement. This required an appraisal by the IRS of the value of the easement. IRS advised us in April 1983, that this would be accomplished by the end of May.

We did not find out until the end of June, 1983 that the IRS attorney auditing the return left IRS soon after our conversation. At the end of August the newly assigned attorney advised us that he could not complete the audit without an appraisal by an IRS engineer and that he was told that all IRS engineers were then in the field investigating tax shelters. We petitioned IRS again in September for a prompt decision on the value of the easement. We were told that the engineering section of

IRS, responsible for appraisals, was independent of the District Director and worked at its own pace. It was not until the end of February, 1984, that we were able to meet with the IRS appraiser.

Since the value of the easement was in issue not only in 1981 when Mr. Chase died, but in 1978, when we deeded it to the Maryland Environmental Trust, the inability of the IRS to make a reasonably prompt appraisal held up not only the closing of Mr. Chase's estate but also the closing of our joint income tax returns for the years 1978, 1979, 1980 and 1981. When issues of valuation were finally resolved last year, the IRS computer was not properly programmed to reflect the settlement. As a result, communications continue to arrive from IRS that incorporate mistakes. We continue to try to correct the computer. There is no acknowledgement from the Philadelphia center, only silence.

I do understand that mistakes will happen. I do not understand why it is impossible to secure a correction of a mistake from the Philadelphia center. I have reached the point where I open every envelope from IRS anxiously and read its contents helplessly. Something must be done, for the tax laws are not being administered, in the words of the Chairman, "fairly and efficiently"—at least in Philadelphia.

NEW YORK, April 19, 1985.

Re: \$100 user fee for nonprofit organizations.

Mr. JOSEPH DOWLEY,

Chief Counsel, Committee on Ways and Means, Longworth Building, Washington, DC.

DEAR MR. DOWLEY: This letter is a statement for inclusion in the above referenced hearing's record, concerning the above noted subject. Six copies of this letter are enclosed.

I. PROPOSAL

The Administration's Fiscal Year 1986 Budget, Part 4—Budget Receipts includes a proposal for a \$100 user fee on private letter rulings and letters of determination for both pension plans and 'tax-exempt organizations', to become effective October 1, 1985. This is estimated to increase receipts by less than \$0.1 billion in each year beginning in 1986. A Summary of Administration's Revenue Proposal prepared by the Staff of the Joint Committee on Taxation (dated February 19, 1985) notes that in 1983 the IRS issued 34,399 private letter rulings, 135,234 advance determination letters on pension plans, and 53,947 determination letters and ruling requests from tax-exempt organizations. These statistics indicate that only 24 percent of total requests were for all letters and ruling issued for tax-exempt organizations.

II. RECOMMENDATIONS

A. Nominal or no fee for public service organizations

I recommend that the fee charged to public service organizations (that is, those seeking determination letters for tax exemption under § 501(c)(3) or (4) of the Internal Revenue Code of 1954, as amended) be dropped or limited to a nominal filing fee such as \$10.

1. The fee is inappropriate because it burdens organizations formed to relieve the government of costs for public service functions.

2. The fee particularly hurts small organizations with 'shoe-string' budgets: these organizations have difficulty getting contributions until after the IRS approves their tax-exempt status. Providing a 'hardship' waiver of the fee would not be a viable solution because these groups would still try to pay the fee, with a disproportionately large detriment to their charitable activities.

3. Weighed against the concerns outlined in 1. and 2., above, the government-level revenue impact is insignificant.

B. Clarification to avoid fee doubling

Currently many organizations file an Application for tax exemption before they have been in existence long enough for a final determination letter. They receive an advance ruling and are required to submit information to the IRS after two years of operations in order to receive their final determinations letter. It is not clear whether the proposed fee would be imposed both with respect to the advance ruling and the final determination, or just once. In my opinion, a user fee should not be imposed with respect to a final determination letter in this circumstance: the IRS ac-

tivity on a well prepared submission for a final determination should not warrant a separate fee.

III. SUPPORTIVE COMMENT

A. In general

Groups organized and operated exclusively for charitable, religious, scientific, educational and other social welfare purposes (i.e., public service organizations generally) should not be charged the proposed \$100 fee for the same reasons that they have been exempt from Federal income taxation under the Internal Revenue Code and its antecedents since 1894. These reasons are founded upon public policies so well accepted that they are difficult to express. Groups such as these are not organized for profit, and they are intended to relieve the government of the cost of fulfilling significant public service functions. In doing the latter they generally respond faster and more effectively to certain substantial public needs for humaneness, schooling, hospitals and scientific research than can the government. In this situation it seems odd that groups forming to relieve the government. In this situation it seems odd that groups forming to relieve the government should be charged by that same government more than a very nominal 'entry fee'. For the same reasons it also seems odd that the government would lose tremendous revenues by permitting the basic exemption from income tax while proposing to raise revenue from a fee that is clearly an insignificant revenue item at the government-level.

B. Small tax-exempt organizations

I have obtained tax-exempt status for several nonprofit organizations through The Council of New York Law Associates on a pro bono basis. Many groups apply to the Council for a volunteer attorney to assist them with incorporation and/or obtaining tax exempt status, and they sometimes have to wait 6 to 8 months before an attorney can be found to help them. Two cases that I have worked on are outlined below. I believe that these examples illustrate the type of small group that would be disproportionately burdened by the proposed \$100 fee.

Example 1.—An advance ruling was obtained for a very small group formed in 1981 with 'shoe-string' funding. The organization was formed to prevent crime by re-programming community institutions and groups, with a special emphasis on directing black youths towards goals that would keep them out of trouble, out of prison. While its general purposes were as old as those of the 'YMCA' and '4-H', it had difficulty obtaining its exemption because it did not want to reduce its goals down to a sports or recreational program in order to gain tax-exempt status. It has struggled since formation with starting and nurturing programs tailored by and for specific communities and neighborhoods. Although its most significant funding milestone was obtaining its tax-exempt status from the IRS, it continues to operate on a very small budget. Since incorporation, all of its legal and accounting work has been done pro bono. Its directors and members receive no compensation other than reimbursement for some of their out-of-pocket costs (and several of them do not submit their costs for reimbursement). It relies primarily on 'free publicity' in magazine articles and in small newspapers' articles, donated time and materials by printers, and word-of-mouth to make people aware of its existence.

To give you an indication of this group's size, please note the following information that the group recently submitted to the IRS in support of its request for a final determination letter:

	1982	1983	1984
Gifts, grants, contributions.....	\$1,585	\$791	\$1,137
Fundraisers—revenues.....		9,325	3,820
Total.....	1,585	10,116	4,957

Example 2.—An advance ruling was obtained for another small group formed in 1983 to provide temporary housing to families that become homeless in the Lower East Side of Manhattan due to emergencies such as evictions, fires and abuse connected with domestic violence. Its goal is to provide safe housing for families in their own community, as well as counsel and other assistance needed to help these families re-adjust.

In order to incorporate their shelter-units into the neighborhoods in a way that the neighborhoods will accept, the group has been rehabilitating relatively small abandoned buildings, which will become low-income cooperative apartment housing

corporations. In one building of approximately 16 residential units, the group will end up with 2 units for use as emergency temporary shelter. Based upon the extent of rehabilitation work provided by its volunteers and its coordinating efforts, the group will also select low income elderly, large families and handicapped persons as the initial occupants of 6 of the units.

In this group all available money is put towards the cost of rehabilitating the buildings and acquiring the necessary furnishings. The group depends heavily upon donations of labor, materials and furnishings. Besides accomplishing its own rehabilitation goals, it has been able to use some of its funding to pay construction trainees, including one group of trainees from Harlem who are ex-offenders.

I hope that this letter will assist the Subcommittee in its analysis of the proposed \$100 fee in the 1986 IRS Budget. Thank you for your attention to this matter, and please do not hesitate to contact me if I can be of assistance.

Yours truly,

DONNA E. JONES.

STATEMENT OF HON. FORTNEY H. (PETE) STARK, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF CALIFORNIA

Mr. Chairman, no one enjoys paying taxes, and filling out the complicated tax forms is just rubbing salt in the wound. It is guaranteed 99.98% of the time to raise one's blood pressure.

We have tried to make tax time a little easier through the Taxpayer Services program—a free program that saves people from unnecessarily going to paid private tax return preparers for help with minor problems.

Unfortunately, in the San Francisco Bay area this spring, Taxpayer Services was unable to keep up with the volume of calls and requests for help. I notice from articles in the Washington Post that similar problems occurred in the Capitol area.

I have found that if you need help over the telephone in the Northern California area, you are likely to have a frustrating experience. My District Office made 38 test calls at various hours to IRS Taxpayer Assistance numbers—both taped answer numbers and “live” numbers—during the middle of March. At the taped answer number, we got through five times, but two times it was busy, three times the system was unavailable, and four times there was just no answer. Calling the number to ask a personal question, we got six answers, but fourteen busy signals.

I bet that this type of response rate is about par for the Nation.

It is unfortunate, because when people can't get through in a reasonable period of time, they are likely to guess the answer, perhaps be more likely to make an error, go out and hire a private tax return preparer unnecessarily, or put off filing their returns until later, thus costing either themselves money (in the case of a refund) or the government money (in the case of taxes owed).

I don't blame the IRS. The Taxpayer Services section has been under severe budget pressure for years. For example, the President's new budget request contains a small cut for this Service and consciously plans on serving 4 million less people than it did last year—thus guaranteeing more busy signals and longer waits to get answers to basic questions.

The real problem is the awesome complexity of the law.

The real answer is massive tax reform. As people look at the Treasury's tax reform proposals and decide whether to support or oppose them, they should remember it will eliminate 10 lines from the 1040 form and get rid of at least 16 entirely. It will reduce the number of those who itemize from 36 percent of all taxpayers to 25 percent, and in time, over half of all taxpayers would not even need to file returns.

Until we get this kind of reform and simplification, I would urge you to urge the IRS to permit the several thousand new IRS examiners which are going to be hired to “swing over” to help the Taxpayer Services operation during the busiest time of the year.

The kinds of delays and frustrations I found in the Northern California area should not be allowed to continue. That is not taxpayer service. It is just more taxpayer frustration.